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No. 86-____

IN THE

Supreme Court of the United States

OCTOBER TERM, 1986

SECURITIES INDUSTRY ASSOCIATION,

Petitioner,

—v.—

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, *et al.*,

Respondents.

APPENDIX TO PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

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SECURITIES INDUSTRY ASSOCIATION

—v.—

THE BOARD OF GOVERNORS OF THE
FEDERAL RESERVE SYSTEM, *et al.*, APPELLANTS

BANKERS TRUST COMPANY

APPEALS FROM THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

(Civil Action No. 80-2730)

Argued April 4, 1986

Decided December 23, 1986

Richard M. Ashton, Attorney, Board of Governors of the Federal Reserve System, with whom Richard K. Willard, Assistant Attorney General, Anthony J. Steinmeyer, Nicholas S. Zeppos, Attorneys, Department of Justice, Robert M. Kimmitt, General Counsel, Department of Treasury and Richard V. Fitzgerald, Chief Counsel, Office of Comptroller of the Currency were on the brief for appellants, Board of Governors of the Federal Reserve System, *et al.* in No. 86-5139.

Paul L. Friedman, with whom John W. Barnum, Laura B. Hoguet and James D. Miller were on the brief for appellant, Bankers Trust Company in Nos. 86-5089, 86-5090 and 86-5091.

James B. Weidner, with whom David A. Schulz was on the brief for appellee in Nos. 86-5089, 86-5090, 86-5091 and 86-5139.

Paul Blankenstein was on the brief for *amicus curiae*, Marine Midland Bank, N.A., urging reversal.

Robert S. Rifkind was on the brief for *amici curiae*, New York Clearing House Association and California Bankers Clearing House Association, urging reversal.

Leonard H. Becker and Daniel I. Prywes were on the brief for *amicus curiae*, Goldman, Sachs & Co., urging affirmance.

John J. Gill, III and Michael F. Crotty were on the brief for *amicus curiae*, American Bankers Association, urging reversal.

Michael S. Hefler, Richard F. Goodstein, Henry T. Rathbun and Arnold M. Lerman were on the brief for *amicus curiae*, Dealer Bank Association, urging reversal. Ronald J. Greene and Kerry W. Kircher entered appearances for *amicus curiae*, Dealer Bank Association.

Linda Chatman Thompson was on the brief for *amicus curiae*, Morgan Guaranty Trust Company of New York, urging reversal.

Harvey L. Pitt, Henry A. Hubschman and David M. Miles were on the brief for *amicus curiae*, Investment Company Institute, urging affirmance.

Before:

MIKVA, EDWARDS and BORK,

Circuit Judges.

Opinion for the Court filed by Circuit Judge BORK.

BORK, *Circuit Judge*:

This is an appeal from an order of the district court invalidating under the Glass-Steagall Act a decision of appellant Board of Governors of the Federal Reserve System that permitted appellant Bankers Trust Company, a state-chartered commercial bank and a member of the Federal Reserve System, to place commercial paper issued by third parties. The Act prohibits commercial banks from engaging in investment banking. The Board of Governors determined that Bankers Trust's activities did not cross the line into investment banking, but the district court concluded that they did. After considering the language and history of the Act and the applicable case law, we reverse the judgment of the district court and reinstate the Board's decision.

I.

"Commercial paper" comprises unsecured, large denomination promissory notes written with maturities of less than nine months to supply the current capital needs of corporate issuers. In privately negotiated transactions, issuers typically place commercial paper with large, financially sophisticated institutional investors (such as insurance companies or pension funds).

Bankers Trust acts as an advisor and agent to commercial paper issuers by advising each issuer of the interest rates and maturities that institutional investors are likely to accept, by soliciting prospective purchasers for commercial paper the client decides to issue, and by placing the issue with the purchasers. Bankers Trust does not make any general advertisement or solicitation regarding any issue it is seeking to place, and does not place any issues with individuals or the general public.

Bankers Trust receives a commission for its services based upon a percentage of the issuer's total outstanding commercial paper during a one-year period. To ensure that it acts solely as an agent without an independent financial stake in the success

of issues it places, which would clearly involve it in investment banking, Bankers Trust does not purchase or repurchase for its own account, inventory overnight, or take any ownership interest in any commercial paper it places. Nor does Bankers Trust any longer make loans on or collateralize loans with the paper it places (a practice it formerly followed when necessary to remedy any deficiency in placement of an issue).

This appeal is the latest installment in a dispute that began in 1979 when the Securities Industry Association ("SIA"), a trade association of underwriters, brokers, and securities dealers, petitioned the Board of Governors for a ruling that it was unlawful for Bankers Trust and other commercial banks to sell commercial paper issued by unrelated entities. The Board ruled against the SIA, but ultimately the Supreme Court, disagreeing with the Board of Governors, held that commercial paper is included within the category of "notes or other securities" addressed by the Banking Act of 1933, commonly known as the Glass-Steagall Act, and remanded the case for a determination of an unresolved issue: whether Bankers Trust's placement of commercial paper constituted the "underwriting" or "business of issuing, underwriting, selling or distributing" that the Act prohibits. *Securities Indus. Ass'n* v. *Board of Governors of the Fed. Reserve Sys.*, 468 U.S. 137, 160 n.12 (1984) (*SIA*).

Upon remand, the Board of Governors found that Bankers Trust's placement of commercial paper constituted the "selling" of a security without recourse and solely upon the order and for the account of customers, a practice permitted by section 16 of the Act, 12 U.S.C. § 24 (Seventh) (1982). Federal Reserve System, Statement Concerning Applicability of the Glass-Steagall Act to the Commercial Paper Activities of Bankers Trust Company (June 4, 1985) ("Board Statement"), Joint Appendix ("J.A.") at 195. The district court reviewed the Board's decision on the petition of the SIA and granted SIA summary judgment, holding that Bankers Trust's activities involved the "underwriting" and "distributing" prohibited by section 21(a)(1) of the Act, 12 U.S.C. § 378(a)(1) (1982). *Securities Indus. Ass'n* v. *Board of Governors of the Fed.*

Reserve Sys., 627 F. Supp. 695 (D.D.C. 1986). This appeal followed.

II.

In reviewing the Board's decision, we owe the agency's determination "the greatest deference." *Board of Governors of the Fed. Reserve Sys.* v. *Investment Co. Inst.*, 450 U.S. 46, 56 (1981) (ICI); *accord Securities Indus. Ass'n* v. *Board of Governors of the Fed. Reserve Sys.*, 468 U.S. 207, 217 (1984) (*Schwab*) (giving Board "substantial deference"); *see also Board of Governors of the Fed. Reserve Sys.* v. *Agnew*, 329 U.S. 441, 450 (1947) (Rutledge, J., concurring) ("[The Board's] specialized experience gives [it] an advantage judges cannot possibly have, not only in dealing with the problems raised for [its] discretion by the system's working, but also in ascertaining the meaning Congress had in mind in prescribing the standards by which [the Board] should administer it."). This principle is not contradicted by *SIA*, 468 U.S. at 143-44 (according only "little deference"), or *Investment Co. Inst.* v. *Camp*, 401 U.S. 617, 626-28 (1971) (*Camp*) (rejecting a deferential approach).

In the latter cases, the agency involved failed to present the Court with anything to which to defer. In *Camp*, Justice Stewart, writing for the majority, noted that "courts should give great weight to any reasonable construction of a regulatory statute adopted by the agency charged with the enforcement of that statute," 401 U.S. at 626-27, but said the "difficulty" was that the Comptroller of the Currency had promulgated the challenged regulation "without opinion or accompanying statement," *id.* at 627. Without the benefit of any "expressly articulated position at the administrative level," the Court refused to defer to the agency's position, reasoning that "[i]t is the administrative official and not appellate counsel who possesses the expertise that can enlighten and rationalize the search for the meaning and intent of Congress." *Id.* at 627-28.

In *SIA*, the Board had provided an opinion explaining its view of whether commercial paper constituted "securities" for purposes of the Glass-Steagall Act but failed to analyze the legislative purposes behind the Act. Because of this omission, the Court gave "little deference" to the Board's position that its interpretation ran afoul of none of the purposes of the Act. 468 U.S. at 143-44. The Court at the same time observed generally that because "[t]he Board is the agency responsible for federal regulation of the national banking system, . . . its interpretation of a federal banking statute is entitled to substantial deference." *Id.* at 142.

In the present case, as in *ICI* and *Schwab*, the Board has comprehensively addressed the language, history, and purposes of the Act that bear on whether commercial banks should be able to place commercial paper. We consequently owe the Board's determination "substantial deference" or "significant weight," and we must look to *Chevron U.S.A. Inc.* v. *NRDC*, 467 U.S. 837 (1984), to guide our application of such principles of review. *See Investment Co. Inst.* v. *Conover*, 790 F.2d 925, 932 (D.C. Cir. 1986). Since Congress has not clearly addressed the question of whether activities such as those conducted by Bankers Trust fall within the prohibitions of the Act, we must examine whether the agency, in filling the statutory gap left by Congress, has acted reasonably. *Chevron*, 467 U.S. at 843-45.

III.

The question in this case involves the interplay of sections 16 and 21 of the Glass-Steagall Act. These provisions implement what the Supreme Court has described as the Act's "general purpose of separating as completely as possible commercial from investment banking," *ICI*, 450 U.S. at 70. Section 16, 12 U.S.C. § 24 (Seventh) (1982), draws the line between permissible and impermissible activities for commercial banks, while section 21(a)(1), 12 U.S.C. § 378(a)(1) (1982), draws this line for investment banks. The Supreme Court has found that "§ 16 and § 21 seek to draw the same line." *SIA*, 468 U.S. at 149. The issue before us is whether the Board has reasonably

determined that the activities of Bankers Trust do not cross that line between commercial and investment banking.

Section 16 of the Act provides in relevant part that the "business of dealing in securities and stock by [a commercial bank] shall be limited to purchasing and selling such securities and stock without recourse, solely upon the order, and for the account of, customers, and in no case for its own account, and the [bank] shall not underwrite any issue of securities or stock." 12 U.S.C. § 24 (Seventh) (1982). Section 21(a)(1) makes it "unlawful" for

> any person, firm, corporation, association, business trust, or other similar organization, engaged in the business of issuing, underwriting, selling, or distributing, at wholesale or retail, or through syndicate participation, stocks, bonds, debentures, notes, or other securities, to engage at the same time to any extent whatever in the business of receiving deposits subject to check or to repayment upon presentation of a passbook, certificate of deposit, or other evidence of debt, or upon request of the depositor.

12 U.S.C. § 378(a)(1) (1982). Because no one disputes that Bankers Trust constitutes a commercial bank within the meaning of these sections, we must determine, first, if the Board has reasonably concluded that the commercial paper placement activities of Bankers Trust fall within the permissive language of section 16. To determine this, we must look at the question of what the statute means by "underwrite," for underwriting not only triggers section 21's prohibitions but also defeats section 16's permissive effect. We must, in contrast, address the meaning of section 21's terms "issuing, selling, or distributing" only if section 16 is inapplicable. In other words, section 21 cannot be read to prohibit what section 16 permits. *See ICI*, 450 U.S. at 63 (section 21 not intended to bar banking practices permitted by section 16); *see also United States* v. *Menasche*, 348 U.S. 528, 538-39 (1955) (rejecting an interpretation of a statutory provision that would nullify the effect of another provision). Therefore, if we find that the Board acted reasonably in concluding that section 16 permits Bankers Trust's activities, that is the end of our analysis.

While this proposition seems obvious, SIA nonetheless argues that we must examine both the prohibitions of section 21 and the permissive phrase of section 16 to determine if the Board has erred. SIA seeks to restrict the scope of section 16 by relying on language (added to section 21 in 1935) that expressly refers to section 16 as an exception to section 21's restrictions, stating that "the provisions of this paragraph shall not prohibit national banks or State banks from dealing in, underwriting, purchasing, and selling investment securities, or issuing securities, to the extent permitted to national banking associations by the provisions of [section 16 of the Act]." 12 U.S.C. § 378(a)(1) (1982). SIA directs our attention to a passage in the House Report accompanying the 1935 amendments stating that this language was added to "make it clear that [section 21] does not prohibit any financial institution or private banker from engaging in the securities business to the limited extent permitted to national banks under [section 16]." H.R. Rep. No. 742, 74th Cong., 1st Sess. 16 (1935). The Report goes on to say parenthetically that this provision permits commercial banks to deal in or underwrite only certain enumerated government obligations not at issue in this case. *Id.* SIA has suggested that the overlap between sections 16 and 21 is restricted to this narrow context, and that we must affirm the district court if we find, as SIA argues, that the language of section 21 covers the transaction permitted by the Board in this case.

SIA's argument is wholly unpersuasive for several reasons. First, the House Report said that the cross-reference to section 16 was being added to "make it clear" that commercial banks could underwrite and deal in certain government obligations, and the title of the relevant passage in that Report was "Section 21 of the Banking Act Clarified." H.R. Rep. No. 742, *supra*, at 16. That this amendment sought merely to *clarify* the relationship between section 16 and section 21 necessarily implies that before the amendment the two provisions by their own force had to be read together. Congress amended section 21 simply to leave no doubt of the need to read the two sections harmoniously in a matter of particular congressional

concern. Moreover, apart from this apparent purpose, the sweeping and comprehensive language employed explicitly provides that any restriction on the activities of a commercial bank that may arise because of the prohibitions of section 21 is relieved insofar as the activity is permitted by section 16. This unambiguous language controls our reading of the statute.

We reject SIA's position for a second and independently decisive reason. If section 21 prohibited what section 16 explicitly permits, section 21 would render section 16's permissive language entirely nugatory—an absurd result. Section 16 allows a commercial bank to sell securities "without recourse, solely upon the order, and for the account of, customers, and in no case for its own account." Section 21, in sharp contrast, flatly prohibits a commercial bank from "selling" securities. If we permitted the restrictions of section 21 to control, the "selling" of securities would be entirely proscribed, despite the explicit permission contained in the statute. If, on the other hand, we read section 16's permissive provisions as an exception to section 21, the restriction on selling in section 21 would retain its force for all activities not permitted by section 16. We must therefore read section 21's operative terms (issuing, underwriting, selling, distributing) to exclude any activity section 16 allows. (We discuss below the prohibition of underwriting by a commercial bank contained in section 16 itself.)

Finally, because the Supreme Court has stated that sections 16 and 21 "seek to draw the same line" between commercial and investment banking, *SIA*, 468 U.S. at 149, those activities of commercial banks that section 16 places on the acceptable commercial banking side of the line cannot be placed by section 21 on the impermissible investment banking side of the line. Thus, if the Board reasonably found that section 16 permits Bankers Trust's activities, our inquiry ends there.

IV.

We believe that the Board's determination is reasonable. The Board found that Bankers Trust's activities fall within section 16's requirement that "[t]he business of dealing in securities and stock by the [bank] shall be limited to purchasing and

selling such securities and stock without recourse, solely upon the order, and for the account of, customers, and in no case for its own account, and the [bank] shall not underwrite any issue of securities or stock." 12 U.S.C. § 24 (Seventh) (1982). While the district court did not dispute the Board's finding that Bankers Trust's activities "fit neatly within the literal language of section 16's permissive phrase," and relied instead on an analysis of the legislative purposes of the Act to reverse the Board's holding, *see Securities Indus. Ass'n* v. *Board of Governors*, 627 F. Supp. at 701-02, SIA vigorously disputes on several grounds the conclusion that the bank's activities come within the permissive language of that section. We take up these arguments in turn.

A.

SIA argues that section 16's permissive language does not apply to the activities of Bankers Trust because the section 16 exception applies only to "the business of dealing in securities and stock," while SIA asserts that the term "dealing" is typically understood to encompass the purchasing and selling of securities only in the secondary trading market. In support of this argument, SIA cites the definition of "dealer" contained in the Securities Act of 1933. In fact, the Securities Act undercuts SIA's position by defining a "dealer" as "any person who engages as agent, broker, or principal, in the business of offering, buying, selling, or otherwise dealing or trading in securities issued by another person," without any exclusion of the primary offering market. 15 U.S.C. § 77b(12) (1982). Moreover, the so-called "dealer's exemption" to registration of securities under the Securities Act makes it clear that one may be a dealer under that statute in both secondary and primary markets. This exemption from registration, contained in section 4(3) of the Securities Act, 15 U.S.C. § 77d(3) (1982), applies to "transactions by a dealer (including an underwriter no longer acting as an underwriter in respect of the security involved in [the] transaction)." This language necessarily implies that one may be a dealer—"in the business of offering, buying, selling, or otherwise dealing or trading in securities" —

and still act as an underwriter—one who unquestionably may participate in the primary or new issue market. Congress' ordinary understanding of "the business of dealing" clearly was not restricted to secondary trading; SIA's argument on this point is unsupportable.

B.

SIA also contends that the Board erred in concluding that the activities of Bankers Trust are "upon the order . . . of . . . customers," claiming that Congress imposed this restriction to make it clear that banks could perform the transactions permitted by section 16 only as an accommodation to the existing customers of the bank. In support of this proposition, SIA relies most exclusively on the Supreme Court's recent opinion in *Schwab,* in which SIA unsuccessfully challenged a bank holding company's retail brokerage operations under section 20 of the Glass-Steagall Act. *See* 12 U.S.C. § 377 (1982) (prohibiting bank affiliation with any firm "engaged principally in the issue, flotation, underwriting, public sale, or distribution" of securities). In approving the retail brokerage operation, run by a non-bank affiliate of the bank holding company as an accommodation to the affiliate's customers, the Court relied in part on the fact that section 16 "allows banks to engage directly in the kind of [retail] brokerage activities at issue here, to accommodate [their] customers." 468 U.S. at 221. SIA suggests that this statement amounted to an interpretation of section 16 requiring banks to provide securities services under the relevant language only as an accommodation to the bank's preexisting customers. This argument misses the mark. While the Court did state that section 16 permitted retail brokerage as an accommodation to customers of the bank's other services, it specifically left open the question whether such securities brokerage, if more broadly available, would still satisfy that provision. *Id.* at 219 n.20. Thus, the Court did not, as we must, decide whether section 16 allows the placement of securities only as an accommodation to existing customers of other bank services.

While the meaning of "upon the order . . . of . . . customers" is decidedly ambiguous, we defer, as *Chevron* requires, to the Board's reasonable conclusion that section 16 should not be given such a narrow reading. The Board below correctly observed that "[n]othing in the literal terms of section 16 requires a preexisting customer relationship." Board Statement at 16, J.A. at 210. According to SIA, however, the legislative history makes it clear that Congress had such a relationship in mind when it included the language "upon the order, and for the account of, customers." In support of its thesis, SIA directs to us a remark in the committee reports that the purpose of section 16 was to permit "[n]ational banks to purchase and sell investment securities for their customers to the same extent as heretofore." S. Rep. No. 77, 73d Cong., 1st Sess. 16 (1933); H.R. Rep. No. 150, 73d Cong., 1st Sess. 3 (1933). Because the Supreme Court in *Schwab* stated that "[b]anks long have arranged the purchase and sale of securities as an accommodation to their customers," and that section 16, read in conjunction with the above-cited legislative history, "expressly endorsed this traditional banking function," 468 U.S. at 215, SIA contends that section 16 was intended *only* to permit such services as had been traditionally performed as an accommodation to preexisting customers of the bank.

SIA again reads too much into *Schwab*. Congress, in enacting section 16, may well have intended to endorse traditional banking services as they existed before 1933. This does not mean, however, that section 16 permits the transactions covered by its language *only* to the extent that identical transactions occurred prior to the enactment of Glass-Steagall. Since nothing in the language or legislative history of section 16 even remotely suggests that the Act meant to freeze particular functions in place as of 1933, we decline to read that meaning into the Act.

Moreover, the history of commercial banking shows that, prior to the Glass-Steagall Act, banks offered the securities brokerage services at stake in *Schwab* both to existing customers and to persons with no preexisting relationship to the banks. *See Securities Indus. Ass'n* v. *Comptroller of the*

Currency, 577 F. Supp. 252, 255 (D.D.C. 1983), *aff'd per curiam*, 758 F.2d 739, 740 (D.C. Cir. 1985) (affirmed "generally for the reasons stated" by district court), *cert. denied*, 106 S. Ct. 790 (1986); *see also Greenfield* v. *Clarence Sav. Bank*, 5 S.W.2d 708, 708-09 (Mo. Ct. App. 1928) (transaction in which plaintiff, having no account with the bank, "went there with the sole purpose of purchasing bonds as an investment"); Smith, *Stock Market Service Comes High*, Am. Bankers A.J. 965 (Apr. 1929) (bank will "buy and sell securities for its customers and the public in general"). Thus, we may not construe "upon the order . . . of . . . customers" to require a preexisting relationship between the bank and the user of the services permitted under section 16, since Congress intended that language to ratify banking practices that served at least some persons without any relationship to the bank except as "customers" of the services permitted by section 16.

Despite the conclusion that section 16 requires no preexisting customer relationship as a matter of law, we still must inquire whether the Board reasonably concluded that Bankers Trust places commercial paper solely on the order of the issuer. The Board stated that "[A]ccording to Bankers Trust's submission, the issuer, not the bank, decides whether to raise funds by issuing commercial paper and, if so, in what amount." Board Statement at 15-16, J.A. at 209-10. The Board concluded that this meant that "the bank places commercial paper solely on the request and on the order of its customer, the commercial paper issuer." *Id.* at 18, J.A. at 212. SIA counters that the banks solicits the business of issuers and gives financial advice about the terms and timing of the potential issue of commercial paper. Neither point upsets the Board's conclusion.

SIA offers no support for its claim that Bankers Trust recruits or solicits the business of issuers beyond the assertion that the bank "touts" its placement services in advertisements.[1]

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1 SIA directs us to an advertisement in which Bankers Trust claims credit for "initiat[ing]" an issuer's commercial paper placement program to show that the bank's placement activities are not solely upon the order of customers. SIA may not seek by this proffer of facts not before the Board to refute the Board's factual premise that the issuer decides whether and in what

"Touting" is not enough to render the Board's conclusion unreasonable. Although the bank may generally solicit customers for its placement services by making it known that such services are available, either in the so-called "tombstone ads" or in more general advertisements (for example, "What do you get when you combine an investment bank with a commercial bank? Bankers Trust Company"), any given placement of commercial papers still takes place solely on the order of the customer. We illustrate by analogy. The Supreme Court in *Schwab* stated that section 16 permitted banks to engage in retail brokerage operations at least to their own customers. Even if we assume that a bank makes its retail brokerage operations available only to its depositors, it still must find some way to let them know that these services are available. It would strain credulity to assert that the circulation of a brochure or the running of an advertisement to publicize the availability of these services would mean that the brokerage services performed are now barred since no longer performed solely upon the order of the customer.

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amount to raise funds by offering commercial paper. While the case comes to us on a review of a grant of summary judgment in which the district court relied on facts, like the foregoing, that were not before the Board, such reliance was improper. The question before us is whether, upon the facts supplied to the Board by Bankers Trust or by the Board's own assumptions, the Board reasonably determined the applicability of the relevant provisions of the Glass-Steagall Act. To the extent that the parties attempt to introduce new facts not before the Board, they mistake the function and scope of our review. Even if the facts upon which the Board relied are not accurate, this does not affect our review of the Board's decision; any inaccuracy will properly be remedied by the Board's enforcement of the Act on the facts that exist at that point.

Moreover, even if Bankers Trust did "initiate" the particular issuer's commercial paper program, as stated in the advertisement, it is not at all clear that this would defeat the exemption. If the customer decided to inquire about commercial paper and, on a rational assessment of the facts and advice supplied by the bank, decided to place successive issues of paper using Bankers Trust as its agent, the sale of those issues would still be solely upon the order of the issuer, even though Bankers Trust might fairly claim that as advisor and agent, it "initiated" the program.

Nor are we convinced that the rendering of financial advice itself removes Bankers Trust's placements from the category of transactions made solely upon the order of customers. Nothing in section 16 suggests that the bank may not advise issuers who have decided that they may or do want to raise money by issuing commercial paper. If a customer asks the advice of Bankers Trust but makes it own decision about whether and in what amount to issue commercial paper, the transaction is made solely on the order of that customer. Consider, by contrast, a case in which an investment bank decides that the market if favorable to the refinancing of a bond issue or the conversion of debt to equity and initiates discussions with its customer leading up to the eventual transaction. In such a situation, the initiative of the investment banker itself creates the very demand for the particular transaction. This is a far cry from the type of passive advice that Bankers Trust renders after the issuer has decided that it needs to raise capital and must only decide the best way to do it. Indeed, the legislative history provides support for just this distinction, evincing a concern about bankers who found it "necessary . . . to seek for customers to become makers of issues of securities when the needs of those customers for long-term money were not very pressing." 75 Cong. Rec. 9911 (1932) (remarks of Sen. Bulkley). We cannot conclude that the Board acted unreasonably in deciding that the danger identified by Senator Bulkley does not characterize the financial advice rendered by Bankers Trust.

SIA also argues that, because section 16 applies both to "purchasing and selling" of securities, the solicitation of buyers of commercial paper by Bankers Trust means that its activities are not "upon the order . . . of . . . customers." This argument is meritless. Since Bankers Trust acts as sales agent for the issuer, it is clearly engaged in "selling" securities for its customers and necessarily finds and solicits buyers for those securities, buyers who may be customers of other bank services. This does not mean, however, that Bankers Trust is "purchasing" securities for those investors who buy the paper. The buyers decide upon and make their own purchases, while

Bankers Trust has an explicit policy against purchasing for any account that it manages, advises, or serves as trustee—the only accounts for which the bank would even have the authority to make such purchases.[2]

Moreover, no sensible construction of the statute could say that otherwise permissible selling activities cannot involve the solicitation of buyers. The seller's very purpose in engaging a selling agent and paying a commission is to acquire that agent's superior ability to place the product with buyers. If placement of the product with buyers did not require any solicitation of buyers, no rational business would pay another firm to do what it could without cost to itself: passively wait for orders. This construction of "upon the order . . . of . . . customers," therefore, would lead to the absurd statutory result of allowing a seller-agent relationship to arise only in circumstances that not only would never actually exist but that also would strip the relationship itself of its purpose. The Board's rejection of such a construction appears eminently reasonable.

C.

The final assault on the Board's conclusion that the activities of Bankers Trust fit within the terms of section 16 suggests that these activities amount to "underwriting" and thus divest Bankers Trust of its exemption. Although the Act and its legislative history are barren of any definition of the term "underwriting," the parties and the district court have spent much effort considering whether the term "underwriting" includes agency, as well as principal, transactions, and whether

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2 Interpreting § 16 to allow solicitation of buyers by Bankers Trust does not nullify the existence of the term "purchasing" in that section. If the bank had a service designed to provide buyers, for a fee, with the securities they desired, the bank would obviously be purchasing the securities for those buyers, and the bank might be precluded from soliciting any particular order from them. In the case of placing commercial paper, the bank is in the business of "selling" securities. The bank is the agent of the issuer, who pays the bank's commission; since the bank is not "purchasing" securities on behalf of or for the buyers, its solicitation of their purchases does not even implicate § 16.

what is commonly called "best efforts" underwriting, in which the selling group assumes none of the risk of its failure fully to distribute the issue, amounts to statutory underwriting for purposes of the exemption.[3] These efforts were needless, since we find that the Board reasonably concluded that an "underwriting" defeats the section 16 exemption only if it includes a public offering; private placements therefore do not for this purpose constitute statutory "underwriting." The Board's reliance on the distinction between public offerings and private placements is reasonable because the distinction derives support from congressional intent embodied in contemporaneous securities legislation and reasonably relates to concerns that the Glass-Steagall Act sought to meet.

1. *Contemporaneous Securities Legislation*—The Glass-Steagall Act nowhere defines "underwriting," and the legislative history contains nothing to clarify the term. When in *SIA* the Supreme Court reviewed the case we now consider on remand, similar ambiguity surrounded the definition of the terms "security" and "note." The Court in *SIA* made it very plain that the meaning of a term in other legislation passed roughly at the same time as the Glass Steagall Act with the shared purpose of restoring confidence in the nation's financial

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3 We do not believe that § 16 gives unlimited rein to banks in the performance of agency transactions, as Bankers Trust suggests. We instead read the restriction against underwriting contained in § 16 as an independent restriction on the bank's securities operations that applies even to agency transactions. While some have questioned whether a best efforts underwriting, performed solely on an agency basis, is technically an "underwriting," *see* 1 L. Loss, *Securities Regulation* 172 (2d ed. 1961), this point seems to relate to underwriting in its strict sense of insurance against risk, and not as a term of art in the securities industry. The securities industry and the Securities Act of 1933, 15 U.S.C. § 77b(11) (1982), treat "best efforts" participation in a distribution as "underwriting." Thus, we cannot read § 16's proscription against underwriting as merely addressing the distinction between principal and agent. Such a construction would make little sense, since the main phrase of § 16 makes it abundantly clear that the bank may engage only in agency, not principal, transactions in securities. We need not decide this question, however, since the prohibition against underwriting does not appear to cover the kind of private offering activities at stake here. *See infra* pp. 20-27.

markets provided "considerable evidence" of the "ordinary meaning" Congress attached to the same term in the Glass-Steagall Act itself. *SIA*, 468 U.S. at 150. The statutes to which the Court resorted in discerning congressional understanding of the term "security" were the Securities Act of 1933, 15 U.S.C. § 77a *et seq.* (1982), the Securities Exchange Act of 1934, 15 U.S.C. § 78a *et seq.* (1982), and the Public Utility Holding Company Act of 1935, 15 U.S.C. § 79 *et seq.* (1982). *SIA*, 468 U.S. at 150. In each of these statutes, the sweeping definition of "security" encompasses commercial paper; the Court accordingly found that when Congress meant to exempt commercial paper from the strictures of one of these statutes, it expressly so provided. *Id.* at 150-51. Congress, the Court concluded, understood "that, unless modified, the use of the term security encompasse[d] [commercial paper]." *Id.* at 151.

Only the Securities Act of 1933 defines the term "underwriter" (although the Securities Exchange Act of 1934 provides useful evidence on the meaning of that term as used in the Securities Act). While the evidence of the ordinary congressional cognizance of the term "underwrite" or "underwriter" thus comes from only one piece of similar legislation, that legislation, the Securities Act of 1933, is the closest to Glass-Steagall in time and purpose of the various statutes relied on in *SIA*. The Securities Act and the Glass-Steagall Act were signed into law within three weeks of each other and both statutes were among the legislative reforms that marked President Roosevelt's first hundred days in office. Thus, while the precise purposes of the Securities Act may differ, both emerged from the same effort to restructure the American financial markets; absent any contrary indication, we must consider Congress' understanding of the financial terms it used in one statute highly relevant to discovering the meaning attached to similar but ambiguous terms in the other. With that rule in mind, we turn to the Securities Act of 1933.

SIA contends that the significance of the Securities Act for this case is that it provides an express exemption from registration for "transactions by an issuer not involving any public offering." 15 U.S.C. § 77d(2) (1982). SIA asserts that this

exemption demonstrates Congress' ability knowingly to provide an exemption from statutory requirements for private offerings; Congress failure so to provide in section 16 of the Glass-Steagall Act means that the Board acted unreasonably when by interpreting the term "underwrite" it effectively read such a private offering into the Act. This point would have considerable force, except that the history of the Securities Act's exemption betrays SIA's argument and, in fact, establishes the converse—that Congress did understand the concept of underwriting to connote involvement in a public offering of securities.

The Securities Act in section 2(11) defines an "underwriter" as "any person who has purchased from an issuer with a view to, or offers or sells for an issuer in connection with, the distribution of any security, or participates or has a direct or indirect participation in any such undertaking, or participates or has a direct participation in the direct or indirect underwriting of any such undertaking." 15 U.S.C. § 77b(11) (1982). An "underwriter" thus cannot exist unless a "distribution" exists.

As originally introduced in the House bill that was to become the Securities Act of 1933, the exemption relied on by SIA applied to "transactions by an issuer not with or through an underwriter." *See* H.R. 5480, 73d Cong., 1st Sess. § 4(1) (1933). The House Committee added to this language the phrase "and not involving any public offering." H.R. Rep. No. 85, 73d Cong., 1st Sess. 1 (1933). While the deliberate inclusion of both "not with or through an underwriter" and "not involving a public offering" would ordinarily support the conclusion that Congress viewed the coverage of the two phrases as being different, other legislative history shows that, in fact, both phrases had the same coverage. In interpreting the statute contemporaneously with its passage, the Federal Trade Commission, the agency originally charged with administering the securities laws, observed that a statutory "distribution" necessarily involved a "public offering," thus making it clear that one could not be an "underwriter" in the absence of a public offering. *See* H.R. Conf. Rep. No. 1838, 73d Cong., 2d Sess. 41 (1934). Acknowledging the correctness of the Commis-

sion's interpretation, the same Congress that had passed the Securities Act of 1933 eliminated as "superfluous" the language "not with or through an underwriter" when it amended the Securities Act in Title II of the Securities Exchange Act of 1934. *Id.*; *see* ch. 404, § 203(a)(1), 48 Stat. 881, 906 (1934); *see also* 1 L. Loss, *Securities Regulation* 551 & n.307 (2d ed. 1961) (distribution "more or less synonymous with" public offering). While by no means conclusive, this history offers support for the reasonableness of the Board's view that Congress understood "underwriting" (and, for that matter, "distribution") of securities to connote a public offering, and that the private offerings of commercial paper effected by Bankers Trust do not come within the Glass-Steagall Act's meaning of "underwriting." At the least, it refutes SIA's contention that the Securities Act undercuts the Board's conclusion in this regard.

One further Securities Act argument made by SIA deserves only brief mention. SIA contends that the Board acted inappropriately in "importing" the public offering/private placement distinction from the Securities Act without requiring adherence to the regulations adopted by the Securities and Exchange Commission in enforcing that distinction. This argument is wholly meritless; the Board properly determined that the SEC regulations simply were not germane to the question at hand. The Board has not, as SIA asserts, sought to "import" a statutory exemption from the Securities Act, but merely has looked to the use of terms in a contemporaneous financial regulatory statute to assist it in discerning what Congress meant when it used similar terms ambiguously in the Glass-Steagall Act. This resort to legislative history does not compel the Board to adopt every subsequent aspect of the Securities Act's enforcement.

But even if this were not so, the relevant SEC rules, collectively known Regulation D, do not purport to be a definitive interpretation of what constitutes a non-public offering but merely constitute a "safe-harbor" that guarantees non-public offering status to an issue that complies with their terms. Securities offerings not in compliance with Regulation D may

nonetheless be exempt from registration as "not involving any public offering." *See* 17 C.F.R. § 230.501 (Preliminary Note 3) (1985) (issuer's failure to satisfy Regulation D "shall not raise any presumption that the exemption provided by section 4(2) of the [Securities] Act is not available").

The Board's responsibility in this case was to arrive at a reasonable determination of what should constitute a private offering under the Glass-Steagall Act. The Board found Bankers Trust's activities to constitute a private offering because (1) the bank "places commercial paper by separately contacting large financial and non-financial institutions," (2) the bank "does not place commercial paper with any individuals," (3) "the maximum number of offerees and purchasers of commercial paper placed by the bank in any given case is relatively limited," (4) the bank "makes no general solicitation or advertisement to the public" with respect to the placement of particular paper (though it does advertise its activities in business publications to publicize its availability as an agent to issuers), and (5) "the commercial paper placed with the bank's assistance is issued in very large average minimum denominations, which are not a likely investment of the general public." Board Statement at 29-30, J.A. at 223-24. Such considerations properly determine what distinguishes a private from a public offering of securities; we shall shortly see that they also have a strong relationship to one of the principal concerns that animated the Glass-Steagall Act.

2. *Legislative Purposes*—As the Supreme Court has amply documented, the legislative history of the Glass-Steagall Act shows that, besides "the obvious risk that a bank could lose money by imprudent investment of its funds in speculative securities," Congress sought to address " 'the more subtle hazards that arise when a commercial bank goes beyond the business of acting as fiduciary or managing agent and enters the investment banking business.' " *SIA*, 468 U.S. at 145 (quoting *Camp*, 401 U.S. at 630). The hazards identified by the Court included danger to the impartiality of the bank as a dispenser of financial advice. For example, "Congress con-

cluded that it was unrealistic to expect a banker to give impartial advice about [whether and how best to issue equity or debt securities] if he stands to realize a profit from the underwriting or distribution of securities." *SIA*, 468 U.S. at 146 (citing 75 Cong. Rec. 9912 (1932) (remarks of Sen. Bulkley)). Moreover, the Court pointed to congressional fears that commercial-bank involvement in investment banking might lead to the use of a bank's credit facilities to "shore up a company whose securities the bank sought to distribute" or to facilitate the purchase of securities of the bank's commercial customers. *See id.* at 146-47. Congress, in sum, did not believe that bankers could act as proper fiduciaries if faced with the "pressures" of "involvement in the distribution of securities." *Id.* at 146.

Congress recognized that these pressures largely resulted from the heavy fixed costs incurred by commercial banks in running investment banking operations. In the period immediately preceding the financial collapse that precipitated the enactment of Glass-Steagall, the distribution of an issue of securities took place through an elaborate syndication involving various tiers of purchase, banking, and selling groups managed by an originating banker who handled the negotiations with the issuer. *See* 1 L. Loss, *Securities Regulation* 164-66 (2d ed. 1961). The precise details of the distribution process, as it then existed, are not important for our purposes. What is important is that "a large number of the leading originators of securities, particularly the security affiliates of commercial banks," developed "large selling organizations" in this period. Gourrich, *Investment Banking Methods Prior to and Since the Securities Act of 1933*, 4 Law & Contemp. Probs. 44, 49 (1937). Indeed, the "bank affiliates were particularly active in constructing substantial retail organizations" to distribute the securities to which they had committed themselves as originators or members of a purchase group. *Id.* at 48 n.8.

Congress was well aware of these developments. The heavy overhead incurred by banks to carry these large retail operations caused much of the congressional concern about "subtle hazards" that animated the sponsors of the Glass-Steagall Act.

As one of the principal sponsors stated:

> In order to be efficient a securities department had to be developed; it had to have salesmen; and it had to have correspondent connections with smaller banks throughout the territory tributary to the great bank. Organizations were developed with great enthusiasm and efficiency. The distribution of the great security issues needed for the development of the country was facilitated, and the country developed. But the sales departments were subject to fixed expenses which could not be reduced without the danger of so disrupting the organization as to put the institution at a disadvantage in competition with rival institutions. These expenses would turn the operation very quickly from a profit to a loss if there were not sufficient originations and underwritings to keep the sales departments busy.
>
> It was necessary in some cases to seek for customers to become makers of issues of securities when the needs of those customers for long term money were not very pressing. Can any banker, imbued with the consciousness that his bond-sales department is, because of lack of securities for sale, losing money and at the same time losing its morale, be a fair and impartial judge as to the necessity and soundness for a new security issue which he knows he can readily distribute through channels which have been expensive to develop but which presently stand ready to absorb the proposed security issue and yield a handsome profit on the transaction?
>
> It is easy to see why the security business was overdeveloped and why the bankers clients and country bank correspondents were overloaded with a mass of investments many of which have proved most unfortunate.

75 Cong. Rec. 9911 (1932) (remarks of Sen. Bulkley).

The distinction between public and private offerings meshes well with the congressional goal of eliminating the "subtle hazards" of conflicts of interest and abuse of fiduciary rela-

tionships in banking. Senator Bulkley's remarks show a concern with the development of a vast selling apparatus necessary to participate in the distribution of "great security issues needed for the development of the country" and mirror the unchallenged evidence in the literature that banks in the early twentieth century were building that type of large selling organization.

In light of the specific congressional focus on the large fixed costs that accompanied retail participation in public distributions, it seems highly plausible that one line Congress might have drawn in adopting the permissive language of section 16 of the Glass-Steagall Act was at the point of public offering, a line which could well explain the prohibition against underwriting. While regular involvement in private offerings of securities undoubtedly produces some fixed costs and some attendant pressures, it seems reasonable to think that Congress might have found these relatively minor expenses acceptable when compared with the much heavier fixed burden of having a far-flung retail network to distribute securities to the public. Although implementation of this distinction through the prohibition of commercial-bank underwriting would not address all the "subtle hazards" with which Congress was concerned (for example, it would do nothing to meet the fear that a bank would sell securities for an issuer to help the issuer repay loans to the bank), the prohibition of underwriting is only one of the limitations that section 16 imposes on banks that desire to deal in securities. We believe that the distinction between public and private offerings as drawn by the Board reasonably interprets the prohibition of underwriting and reasonably relates to the elimination of some of those hazards.

V.

While SIA has not met its burden of refuting the reasonableness of the Board's conclusion that Bankers Trust's activities fit within the literal terms of section 16, SIA mounts a final, sweeping challenge to the reasonableness of the Board's interpretation of the Act. SIA asks the court to analyze the

activities approved by the Board to determine whether they pose the "subtle hazards" that the Act seeks to eliminate. The district court relied on the potential for these hazards to conclude that, while the activities of Bankers Trust come within the literal terms of section 16, those terms should be construed narrowly to exclude an otherwise permissible arrangement that frustrates the policies of the Act. In other words, although the language and history of the specific provisions support the reasonableness of the Board's construction of those provisions, the Board might nonetheless be obligated to adopt a different construction if the background policies of the Act as interpreted by the Supreme Court in cases like *Camp* and *SIA* conflict with that construction and render it unreasonable. This admittedly seems at odds with the recent statement by the Supreme Court that

> [a]pplication of "broad purposes" of legislation at the expense of specific provisions ignores the complexity of the problems Congress is called upon to address and the dynamics of legislative action. Congress may be unanimous in its intent to stamp out some vague social or economic evil; however, because its Members may differ sharply on the means for effectuating that intent, the final language of the legislation may reflect hard fought compromises. Invocation of the "plain purpose" of legislation at the expense of the terms of the statute itself takes no account of the processes of compromise and, in the end, prevents the effectuation of congressional intent.

Board of Governors of the Fed. Reserve Sys. v. *Dimension Fin. Corp.*, 106 S. Ct. 681, 689 (1986). But the Supreme Court's Glass-Steagall Act cases uniformly consider "subtle hazards" and examine background purposes of the Act. Until the Court indicates that it no longer employs this analysis to interpret the Glass-Steagall Act, we too must take such considerations into account. We therefore turn to that analysis.

We believe that the district court erred in concluding that the private placement of commercial paper by Bankers Trust creates the kind of "subtle hazards" that would require the Board

to construe section 16 narrowly to exclude that activity. Since the Supreme Court has already undertaken a "subtle hazards" analysis with respect to commercial paper, albeit without the benefit of the Board's analysis of that issue, we know precisely the concerns the Court has identified in this area. What we must decide is whether the practices of Bankers Trust at issue here sufficiently differ from those in the last round of this litigation to justify concluding that the hazards identified are no longer present, or whether the Board has presented new considerations that were not before the Court in *SIA* and that meet the concerns expressed by the Court.

Initially, it bears noting that the most obvious hazard reached by the Act—the investment of bank funds in speculative securities—is not at issue in this case. Bankers Trust does not purchase the commercial paper of its customers; it does not inventory the paper overnight; and it makes no loans to provide financing to an issuer when an offering of paper falls short of its goal. Nothing in Bankers Trust's services puts its own resources at risk.

This takes us directly to the "subtle hazards" analysis, which catalogues the various conflicts of interest and dangers that may result from a commercial bank's dealing in "particular" securities. The first set of potential conflicts involves the bank in its role as a lender, raising the dual specter of the bank's making loans to the issuer (to ensure the success of its issue) or to the purchasers of commercial paper placed by the bank. *SIA*, 468 U.S. at 146-47, 156-57. The Board's analysis adequately answers those concerns.

To avoid any danger of making unsound loans to an issuer, Bankers Trust has, since the Supreme Court decided *SIA*, adopted a policy of providing no back-up credit or guarantees to facilitate the acceptance of commercial paper; any line of credit now granted to an issuer must have "substantially different timing, terms, conditions and maturities from the commercial paper being placed." Board Statement at 40, J.A. at 234. *SIA* does not dispute the salutary nature of this change, but argues that the Board's reliance on such representations amounts to "regulation" in a statute that Congress meant to

operate through "flat prohibitions." This argument is without merit. The Glass-Steagall Act does impose a system of flat "prohibitions" and "prophylactic" measures, *see SIA*, 468 U.S. at 147-48, 157, but this cannot obviate the need to examine particular factual situations to determine on which side of the prohibitory line they fall. Although the Act may seek to prevent even "potential" conflicts, *see ICI*, 401 U.S. at 637-38, this does not foreclose the Board from deciding that the realities of a situation make even the potential for conflict substantially unlikely. Bankers Trust has made representations about the conduct of its loan department that seem to meet the congressional concerns identified by the Supreme Court; it is perfectly appropriate for the Board to credit the bank's new policies. Moreover, we do not believe that the Board's assumption that Bankers Trust will keep adequate records to substantiate its contentions transforms the Board's decision into an instance of "regulation." If a member of the industry were to file charges with the Board, claiming that Bankers Trust was not adhering to its stated policies, the availability of Bankers Trust's records would facilitate the Board's investigation of that charge. It is in no way an impermissible "regulation" to require Bankers Trust to keep adequate records.

The Board has also advanced an argument not considered by the Court in *SIA* to explain why the arrangement adopted by Bankers Trust will not lead to the lending of money to "shore up" customers of the bank's commercial paper service. The Board points out that the profit from the placement of commercial paper is small, amounting to a commission on the order of one eighth of one percent of the total amount of the issuer's commercial paper, computed on an annualized basis. The rewards from these commissions are so small compared to the cost of the loans the bank would have to write to make an unsound issuer's paper more attractive to the market that writing such loans would not be worth the risk. Board Statement at 40-41, J.A. at 234-35. A judgment such as this, that the economic realities of the financial marketplace would preclude banks from making loans to shore up troubled issu-

ers, is precisely the kind of exercise of delegated expertise that deserves our full deference.

The Board has also concluded that there is no appreciable risk of the bank's placing commercial paper to enable a debtor of the bank to repay its loans. The Board's opinion reasons that an issuer unable to repay bank loans will probably be unable to raise money in the commercial paper market in any case; Bankers Trust furthermore has adopted a policy of not providing letters of credit or guarantee arrangements to make such paper more attractive. Board Statement at 44, J.A. at 238. Moreover, the antifraud provisions of the securities laws would compel the disclosure of the intended use of the proceeds to satisfy a potentially bad debt owed to the bank, providing an obvious disincentive to such a transaction. *Id.* Finally, empirical evidence indicates that the proceeds of private placements by banks have not been used to pay off any loans involving a material risk of nonpayment. *Id.* at 45, J.A. at 239. The Board's findings as to these factors, which the *SIA* Court apparently did not consider, are reasonable and accordingly receive our deference.

As for the second "subtle hazard," the possibility of the bank's making self-interested loans to finance the purchase of commercial paper it helps issue, the Board provides a persuasive argument, again not before the Supreme Court in *SIA*, that no such hazard arises here. Turning again to an analysis of financial markets, the Board asserts that it is wholly impractical for a commercial bank to make such loans because the yields on commercial paper are generally lower than the interest rates the loans would have to bear. Board Statement at 41 n.39, J.A. at 235 n.39. In the absence of any evidence that this conclusion is wrong, the Board is again entitled to our deference.

Another category of concerns involves the bank's role as a disinterested financial advisor to its customers. First, there is the potential that the bank will give unsound financial advice to the issuer in order to reap the profits from placement of the issuer's commercial paper. *See SIA*, 468 U.S. at 146. The Board found any such risk to be insignificant because the

profit from such placements is so low that the bank has no incentive to offer deliberately unsound advice. Board Statement at 46, J.A. at 240. This rationale, not considered by the Supreme Court, seems consistent with the notion that much of the concern with banks' giving self-interested advice was based on the banks' need to meet the fixed costs of far-flung distribution networks. *See supra* pp. 25-27. When the rewards and incentives are lower, the potential benefits from rendering unsound and self-interested advice seem likely to be outweighed by the damage to the bank's reputation and goodwill that would arise from giving bad advice. The Board's conclusion that bad advice will not result from the scheme at issue here is rational.

The role of disinterested financial advisor to depositors presents different concerns. Congress feared that depositors purchasing securities through their bank might lose confidence in their bank if an issuer using the bank's securities services defaulted on their securities. *SIA*, 468 U.S. at 155-56. Although Bankers Trust has prevented any conflict of interest concerning any account managed or advised by the bank or its affiliates or for any account in the bank's trust department by adopting a flat rule that it will purchase none of the commercial paper it places for these accounts, Board Statement at 45, J.A. at 239, Bankers Trust does otherwise place commercial paper with its depositors. The Board argues that because the depositors who purchase commercial paper are large, sophisticated business institutions, they would be unlikely to blame their bank for what really amounts to their own error in judgment, while any harm to the bank that did result would not affect its public reputation. *Id.* at 42-43, J.A. at 236-37. Though this assessment seems entirely realistic, the Supreme Court in *SIA* clearly rejected these arguments, stating that the Act makes no distinctions on the basis of financial expertise and that the loss of confidence of a few large depositors might, in fact, prove "especially severe." *SIA*, 468 U.S. at 156, 159. While the Board also argues that an empirical study has indicated no harm to the reputation of commercial banks from their private placements of securities, Board Statement at 42,

J.A. at 236, nowhere does the Board's analysis indicate that the study specifically addressed the effect of issuer defaults on depositor/purchaser confidence in commercial banks.

We believe, however, that despite the existence of this one "subtle hazard," we must still affirm the Board. There are several reasons for that conclusion. First, the "subtle hazards" addressed in *Camp* and returned to in *ICI, Schwab*, and *SIA* have never alone caused the Supreme Court to hold that Glass-Steagall permits or prohibits any particular banking practice. Rather, analysis of the hazards in those cases simply reinforced the Court's conclusion that, as a matter of statutory interpretation, Glass-Steagall permitted or prohibited the questioned practice. Moreover, the Court has concluded that "subtle hazards" counsel prohibition of a banking practice only when the practice gave rise to each and every one of the hazards. *See SIA*, 468 U.S. at 154-59; *Camp*, 401 U.S. at 630-34, 636-38. Nor must a hazard be "totally obliterated" to permit a banking practice—avoidance of the hazard "to a large extent" suffices. *See ICI*, 450 U.S. at 67 n.39. Finally, our conclusion is reinforced by our view that the "subtle hazards" analysis as a whole is a specific instance of the *Chevron* principle that requires our deference to an agency's reasonable construction of its statute's ambiguities, *see Investment Co. Inst.* v. *Conover*, 790 F.2d 925, 931-33, 935-36 (D.C. Cir. 1986) (applying *Chevron* to agency interpretation of Glass-Steagall), since an agency's statutory interpretation that impairs one of the statute's purposes but not others may surely nonetheless be reasonable. (Indeed, the binding force of the Supreme Court's "subtle hazards" analysis in *SIA* is unclear, since, as we have already noted, *supra* pp. 6-7, the Board failed to offer the Court any rationale concerning those hazards to which the Court could defer. *See SIA*, 468 U.S. at 155; *see also ICI*, 450 U.S. at 68 (distinguishing *Camp* on this ground)). We think, in short, that the Board reasonably concluded not only that Bankers Trust's placements of commercial paper meet the literal requirements of section 16, but also that those placements are consistent with the panoply of the Act's purposes.

We therefore reverse the district court's order and reinstate the Board's decision.

It is so ordered.

Order of the Court of Appeals,
April 14, 1986

THE UNITED STATES COURT OF APPEALS

FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 86-5089

September Term, 1985

SECURITIES INDUSTRY ASSOCIATION

—v.—

THE BOARD OF GOVERNORS OF THE
FEDERAL RESERVE SYSTEM, *et al.*

BANKERS TRUST COMPANY,

Appellant

AND CONSOLIDATED CASES

Filed April 14, 1986

BEFORE:

Mikva*, Edwards and Bork,

Circuit Judges

ORDER

It is ORDERED by the court that the stay of the district court order which permanently enjoined Bankers Trust Company from sales of third-party commercial paper in the manner described in the June 4, 1985 Statement of the Board of Governors of the Federal Reserve System, is extended until further order of this court.

Per Curiam

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* Circuit Judge Mikva did not participate in this order.

Order of the Court of Appeals, February 28, 1986

THE UNITED STATES COURT OF APPEALS

FOR THE DISTRICT OF COLUMBIA CIRCUIT

September Term, 1985

No. 86-5089

SECURITIES INDUSTRY ASSOCIATION

—v.—

THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, et al.

BANKERS TRUST COMPANY,

Appellant

AND CONSOLIDATED CASES

Filed February 28, 1986

BEFORE:

WRIGHT, MIKVA AND BORK,

Circuit Judges

ORDER

Upon consideration of the Motion of Bankers Trust Company for a Stay Pending Appeal and to Vacate Injunction, the responses thereto, and the briefs in support of the motion filed by parties participating as *amici curiae*, it is

ORDERED by the court that the district court order issued February 18, 1986, which permanently enjoined Bankers Trust Company from sales of third-party commercial paper in the manner described in the June 4, 1985 Statement of the Board of Governors of the Federal Reserve System, is stayed until April 15, 1986, unless sooner dissolved by the panel chosen to decide the merits of the case. It is

FURTHER ORDERED by the court, on its own motion, that the appeal is expedited and the following briefing schedule is established:

Appellants' brief, briefs of supporting *amici*, if any, and joint appendix	March 10, 1986
Appellee's brief and briefs of supporting *amici*, if any	March 17, 1986
Reply brief, if any	March 21, 1986

The Clerk is directed to schedule oral argument on the first day of the April sitting.

All parties are directed to personally serve and file all briefs.

Per Curiam

Opinion and Order of the District Court,
February 18, 1986

UNITED STATES DISTRICT COURT

FOR THE DISTRICT OF COLUMBIA

Civil Action No. 80-2730

SECURITIES INDUSTRY ASSOCIATION,
Plaintiff,

v.

BOARD OF GOVERNORS OF THE
FEDERAL RESERVE SYSTEM, et al.,
Defendants,

BANKERS TRUST COMPANY,
Defendant-Intervenor.

OPINION AND ORDER

JOYCE HENS GREEN, *District Judge*

Before the Court is plaintiff Securities Industry Association's ("SIA's") motion to enjoin defendant-intervenor Bankers Trust Company from further sales of commercial paper on behalf of third-party issuers. On February 4, 1986, this Court issued a Memorandum Opinion and Order ("February 4 Opinion") holding that such sales violated the Glass-Steagall Act. SIA filed this motion on February 6, following public statements by Bankers Trust that it intended to continue its placement services while it appealed the decision. *See* Wall St. J., Feb. 5, 1986, at 2, col. 2. Bankers Trust filed its opposition and a cross-motion for a stay of the February 4 Opinion on February 10. The Court heard oral arguments on the motions

on February 12. For the reasons set forth below, the Court grants plaintiff's motion for an injunction, but stays its effect until March 1, 1986, and denies Bankers Trust's motion for a stay of the February 4 Opinion.

At the outset, Bankers Trust raises a jurisdictional objection to the issuance of an injunction, which merits little discussion. The bank contends that this Court lacks personal jurisdiction over it because it intervened only for the limited purpose of defending the legality of defendant Federal Reserve Board's June 4, 1985 Statement, and for no other purpose. Bankers Trust's Opposition at 10. This argument is incorrect both as a matter of fact and law. In its motion to intervene, Bankers Trust did not limit its participation to the academic exercise of defending the Board's June 4, 1985 Statement. The bank stated that its intervention in the case was necessary "[i]n order to defend the legality of *its service*," Motion of Bankers Trust Company for Leave to Intervene as of Right at 2 (emphasis supplied), and noted that "[t]he controversy between the Board and the securities industry is based on the activities of Bankers Trust and thus directly and substantially affects [its] business. *Bankers Trust stands to gain or lose from this Court's decision.*" *Id.* at 3 (emphasis supplied). Moreover, the bank simply could not have limited this Court's jurisdiction over it in the manner it suggests. As an intervenor of right, Bankers Trust became "a full participant in the lawsuit and is [to be] treated just as if it were an original party." *Schneider* v. *Dumbarton Developers, Inc.*, 767 F.2d 1007, 1017 (D.C. Cir. 1985). It assumed the risk that it would not prevail and that an order adverse to its interests would be entered. *Id.*, 7A C. Wright & A. Miller, *Federal Practice & Procedure* § 1920 at 611 (1972). Indeed, the possibility that plaintiff would obtain relief against it was the price Bankers Trust paid for its intervention. *District of Columbia* v. *Merit Systems Protection Board*, 762 F.2d 129, 132 (D.C. Cir. 1985). The Court, therefore, concludes that it has personal jurisdiction over Bankers Trust sufficient to enjoin its commercial paper sales activities.[1]

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1 Bankers Trust also filed a notice of appeal on February 10, 1986. While a notice of an appeal ordinarily divests a district court of jurisdiction

Bankers Trust next argues that use of Rule 59(e) is an improper procedural device to expand the scope of relief sought in SIA's original complaint. The bank cites *White* v. *New Hampshire Department of Employment Security*, 455 U.S. 445, 450-51 (1982), a case in which the Supreme Court stated that Rule 59(e) only permits courts to rectify mistakes or reconsider matters properly encompassed in a decision on the merits and argues that SIA, in moving for an injunction, is seeking something entirely new. *White*, however, involved a motion under Rule 59(e) for an award of attorney's fees—a matter clearly beyond those encompassed in the decision on the merits. Here, SIA seeks an injunction to give effect to the Court's February 4 ruling that Bankers Trust's commercial paper activities violate federal law. A court's authority to issue injunctions in aid of its decrees is unquestioned. *See United States* v. *New York Telephone Co.*, 434 U.S. 159, 172-73 (1977); *Dugas* v. *American Surety Co.*, 300 U.S. 414, 428 (1937); *Marshall* v. *Local Union No. 639, International Brotherhood of Teamsters*, 593 F.2d 1297, 1302 (D.C. Cir. 1979). Courts necessarily have the power to enter "such orders as may be necessary to enforce and effectuate their lawful orders and judgments, and to prevent them from being thwarted and interfered with by force, guile, or otherwise." *Mississippi Valley Barge Line Co.* v. *United States*, 273 F. Supp. 1, 6 (E.D. Mo. 1967), *aff'd sub nom. Osbourne* v. *Mississipi Valley Barge Line Co.*, 389 U.S. 579 (1968). Bankers Trust has made clear its intent to continue to sell commercial paper, notwithstanding this Court's ruling that those sales are illegal under the Glass-

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and confers it on the court of appeal, *see Griggs* v. *Provident Consumer Discount Co.*, 459 U.S. 56, 58 (1982), that rule does not obtain in a case such as this one, where a party has filed a timely motion under Rule 59 to amend a judgment. *See* Fed. R. App. P. 4(a); 9 J. Moore's, *Moore's Federal Practice* ¶ 203.11 (1985). In addition, district courts retain jurisdiction to issue orders regarding bonds, or to modify, restore or grant injunctions. *Venen* v. *Sweet*, 758 F.2d 117, 120 n.2; Fed. R. App. P. 7 and 8. Accordingly, Bankers Trust's notice of an appeal in no way undermines this Court's jurisdiction to act on plaintiff's motion for an injunction, and it is therefore unnecessary to rule on plaintiff's motion to declare Bankers Trust's filing of the appeal null and void.

Steagall Ac. An order enjoining further sales is obviously in aid of the Court's February 4 judgment and is accordingly proper under Rule 59(e).

Bankers Trust's final procedural objection to issuance of an injunction is that the Glass-Steagall Act does not create a private cause of action and thus a private party such as SIA cannot use it to enjoin the bank. The Court, however, need not reach the question of whether the Act creates an implied right of action, as its authority to issue an injunction does not derive from that statute, but rather from its inherent power to enter orders in aid of its decree. Moreover, this action was brought under the Declaratory Judgment Act, 28 U.S.C. §§ 2201 and 2202. Section 2202 of that Act "empower[s] . . . district court[s] to grant supplemental relief, including injunctive relief." 28 U.S.C. § 2202; see *also Edward B. Marks Music Corp.* v. *Charles K. Harris Music Pub. Co.*, 255 F.2d 518, 522 (2d Cir.), *cert denied*, 358 U.S. 831 (1958). Whether or not the Glass-Steagall Act creates a private cause of action, therefore, is simply irrelevant for purposes of determining whether this Court may enjoin Bankers Trust's sales activities.

Turning then to the appropriateness of an injunction, the Court is aided by its earlier conclusion that Bankers Trust's activities violate the Glass-Steagall Act. *See* February 4 Opinion. That Act embodies Congress determination that a complete separation of commercial from investment banking necessarily inures to the benefit of the public. *See Securities Industries Association* v. *Board of Governors*, ____ U.S. ____, ____, 104 S. Ct. 2979, 2985 (1984). The Court, of course, is not to second-guess the wisdom of that judgment. Having found that Bankers Trust's sales of third-party commercial paper contravene the flat prohibitions of the Act, it follows that these sales are detrimental to the public good. Against this presumption of public harm, the bank offers essentially two arguments as to why an injunction should not issue, or, if one does, why it should be stayed: (1) that an injunction would cause even greater harm by disrupting the financial markets; and (2) that an injunction would cause irreparable harm to the bank itself. With respect to the first of

these contentions, the bank has offered little evidence to support its prediction that far reaching turmoil will issue if its activities are enjoined, and indeed, some of the bank's own statements belie such an assertion. Bankers Trust submitted the affidavit of Kevin P. Burke, Vice President of its Commercial Paper Group, who stated that all of the approximately 50 commercial paper issuers that the bank serves have expressed concern about the disruption to the commercial paper market posed by the Court's February 4 Opinion. Burke Affidavit at ¶ 4. Attached to the affidavit, however, are five presumably representative letters from the bank's commercial paper clients, not one of which contains any prediction of dire consequences for the commercial paper market generally.[2] More importantly, in arguing that its activities pose little harm to the interests of SIA, Bankers Trust concedes that it accounts for only 2.5 percent of the commercial paper market. Burke Affidavit ¶ 9. It is difficult to see how an injunction against the bank would "create undesirable turmoil in the market for commercial paper" with "far-reaching repercussions," given its small share of the market. In addition, nearly half of Bankers Trust's clients already use more than one commercial paper dealer, Weidner Affidavit, Exh. B, and thus could transfer their business without excessive disruption of their short term financing needs.

The bank's second argument is that it will be irreparably harmed if this Court enjoins its activities. An injunction, it contends, will destroy the client base it has built up over the past seven years, since its present customers will not return to it even if the Court of Appeals subsequently finds its services to be legal under the Glass-Steagall Act. In short, the bank claims that an injunction will effectively strip it of its right to an appeal. In advancing this argument, both in opposition to the injunction and in support of its motion for a stay, Bankers

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2 The letters, although written by five different companies, state in virtually identical language that each company would be forced to switch to another commercial paper placement agent if Bankers Trust is enjoined, and that each would be unlikely to return to the bank's services in the event the Court of Appeals upholds the legality of the bank's activities. The letters appear to reflect more the concerns of the bank itself than those of its clients.

Trust relies extensively on *Washington Metropolitan Area Transit Commission* v. *Holiday Tours, Inc.*, 559 F.2d 841 (D.C. Cir. 1977), a case in which the Court of Appeals emphasized that a stay may be appropriate even where the district court finds that the movant has little likelihood of success on the merits. Injunctive relief pending appeal, the Court stated, is appropriate in order to maintain the status quo where serious legal issues are presented, little if any harm would befall the public in the interim, and denial of such relief would cause irreparable harm to the movant. *Id.* at 844. These same factors are present here, Bankers Trust claims, and counsel against an injunction, or in favor of a stay, while an orderly appeal is taken.

In *Holiday Tours*, however, the Court noted that the case before it was not one "where the Commission has ruled that the service performed by appellant is contrary to the public interest." *Id.* at 843. That is decidedly not the situation here. Bankers Trust's activities have been found to violate federal law, and thus are most definitely contrary to the public interest. At bottom, the bank is making the extraordinary request that this Court maintain a status quo that the Court has concluded is illegal. Under these circumstances, Bankers Trust's showing of irreparable harm would have to be overwhelming indeed in order to justify a stay.

To be sure, Bankers Trust will suffer considerable harm if its placement services are enjoined; at present, it has outstanding over $4 billion of commercial paper that it has placed on behalf of issuers. However, the bank has not demonstrated that the harm it will suffer if an injunction issues will be irreparable. It does not indicate how much income it stands to lose if enjoined from further sales,[3] or what the effect of such a loss of revenues would have on its *overall* net worth. It is clear, however, that an injunction would not put Bankers Trust out of business. Accordingly, the bank could resume its services if the Court of Appeals ultimately decides they are legal. While

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3 Bankers Trust earns a commission on the paper it places, and thus the $4 billion of commercial paper it has outstanding does not translate into an equivalent amount of income.

this would no doubt entail certain start-up costs, the mere existence of such expenses hardly justifies allowing the bank to engage in activities that this Court has concluded violate federal law. In addition, Bankers Trust's placement services have been the subject of legal challenge almost since their inception. The bank has forged ahead, however, despite the very real possibility that its activities might be barred under the Glass-Steagall Act, and has generated revenues over a seven-year period from placement services that have now been judged illegal. The bank attempts to portray itself as an innocent victim about to suffer irreparable injury, but it made a conscious choice to engage in business the legality of which was strongly questioned, and has profited for seven years as the Federal Reserve Board and the courts have sought to resolve that question. Bankers Trust cannot now argue that past illegal activities, all being undertaken in good faith, somehow justify future violations of law.

In short, the bank has failed to demonstrate that the injury it will suffer if a stay is not granted, or if an injunction issues, is so great that this Court must permit it to undertake activities this Court has found to be illegal.

Finally, Bankers Trust argues that injunctions should not issue as a matter of course in every case where a court finds a violation of federal law, and that the application of traditional equitable principles in this case—namely, the balancing of hardships to the parties and the availability of legal remedies—militate against an injunction here. The bank is correct that a finding of a statutory violation does not lead automatically to the issuance of an injunction. *Weinberger* v. *Romero-Barcelo*, 456 U.S. 305, 313 (1982). It is also true, however, that in a number of cases courts have found it unnecessary to inquire into the traditional requirements for injunctive relief when statutory violations are involved. *See United States* v. *City of San Francisco*, 310 U.S. 16, 31 (1940) (equitable doctrines do not deprive courts of power to enforce declared congressional policy); *National Wildlife Federation* v. *Andrus*, 440 F. Supp. 1245, 1256 (D.D.C. 1977) (clear and substantial violation of statute lessens need to balance other equitable factors); *Com-*

munity Nutrition Institute v. *Butz*, 420 F. Supp. 751, 754 (D.D.C. 1976) (where federal statute violated, court need not inquire into traditional requirements for equitable relief); *Sierra Club* v. *Coleman*, 405 F. Supp. 53, 54 (D.D.C. 1975) (same). A review of the various cases makes clear that, where federal statutes are violated, the guiding principle for determining the propriety of equitable relief is whether an injunction is necessary to effectuate the congressional purpose behind the statute. Put another way, in such cases, the equities to be balanced are not simply those of the private litigants, but also the interests of the public as defined by Congress. Thus, in *Weinberger* v. *Romero-Barcelo*, the Supreme Court ruled that the Federal Water Pollution Control Act did not mandate an injunction against naval activities undertaken without compliance with certain permit requirements, since the district court had found that the activities in question did not pollute the waters. The purpose of the statute, the Court stated, was to maintain "[t]he integrity of the Nation's waters, . . . not the permit process." 456 U.S. at 314. Similarly, in *Realty Income Trust* v. *Eckerd*, 564 F.2d 447 (D.C. Cir. 1977), the Court of Appeals for this circuit refused to enjoin construction of certain buildings where the agency had failed to file an environmental impact statement (EIS) within the time periods prescribed by the National Environmental Protection Act. An injunction would serve no remedial purpose, the court concluded, since a final EIS had been submitted and evaluated before any construction had begun. 564 F.2d at 456-57. Conversely, in *Tennessee Valley Authority* v. *Hill*, 437 U.S. 153 (1978), the Supreme Court declined to balance the equities and hardships of an injunction issued against completion of the multi-million dollar Tellico Dam, where operation of the dam would bring about the extinction of the Snail Darter fish, in violation of the Endangered Species Act. Effectuation of Congress clear intent, the Court found, required issuance of the injunction, regardless of the costs involved. *Id.* at 193-94. So also in *United States* v. *City of San Francisco*, the Court refused to weigh the hardships to the parties and affirmed a district court's injunction against the city's sales of electric

power to a private utility. In granting San Francisco certain lands and rights of way in order to enable it to generate hydroelectric power, Congress had expressly prohibited the city from transferring the right to sell the power to a private corporation. "[E]quitable doctrines," the Court stated, "do not militate against the capacity of a court of equity to make a declared policy of Congress effective." *Id.,* 310 U.S. at 31.

As discussed at length in the February 4 Opinion, the statute involved here, the Glass-Steagall Act, lays down a series of flat prohibitions designed to forestall a host of "subtle hazards" and to eliminate potential conflicts of interest that Congress believed might arise if commercial banks underwrite or otherwise promote the sale of securities. This Court has found that Bankers Trust's activities contravene those prohibitions and that precisely those promotional pressures that Congress sought to root out of the commercial banking industry inhere in its sales of commercial paper. This is not a case, therefore, where the violation at issue does not implicate the core concerns underlying the statute, or where alternative regulatory measures are available to protect the public interest. Here an injunction is essential "to make a declared policy of Congress effective." In other words, Congress has dictated the balance of equities by determining that the public interest requires a complete separation of commercial and investment banking. This Court need not look further.

Accordingly, for all the foregoing reasons, it is hereby

ORDERED that Bankers Trust Company be and it hereby is permanently enjoined from sales of third-party commercial paper in the manner described in the June 4, 1985 Statement issued by defendant Board of Governors of the Federal Reserve System.

IT IS FURTHER ORDERED that the effect of this Opinion and Order be and it hereby is stayed until March 1, 1986, in order to allow the bank a reasonable amount of time to discontinue its commercial paper placement services in an orderly fashion and to apply to the Court of Appeals for a stay of the injunction and the February 4, 1986 Opinion pending appeal.

IT IS FURTHER ORDERED that plaintiff Securities Industry Association shall post with the Clerk of the Court a bond of one hundred thousand dollars ($100,000), in cash or surety, within 48 hours of issuance of this injunction, failing which the injunction shall stand immediately dissolved.

IT IS FURTHER ORDERED that Bankers Trust Company shall post with the Clerk of the Court a bond of one hundred thousand dollars ($100,000), in cash or surety, within 48 hours of issuance of this Order, failing which the stay shall stand immediately dissolved.

It is, this 18th day of February, 1986 at 3:40 p.m.

SO ORDERED.

/s/ Joyce Hens Green
JOYCE HENS GREEN
United States District Judge

Opinion and Order of the District Court,
February 4, 1986

UNITED STATES DISTRICT COURT

FOR THE DISTRICT OF COLUMBIA

Civil Action No. 80-2730

SECURITIES INDUSTRY ASSOCIATION,

Plaintiff,

—v.—

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, et al.,

Defendants,

BANKERS TRUST COMPANY,

Defendant-Intervenor.

MEMORANDUM OPINION AND ORDER

JOYCE HENS GREEN, District Judge.

Plaintiff, Securities Industry Association ("SIA"), a trade association representing the nation's securities dealers and underwriters, challenges a decision of the Federal Reserve Board ("Board") permitting Bankers Trust Company to place commercial paper with investors on behalf of issuers under certain prescribed conditions. Specifically, in its ruling of June 4, 1985, the Board determined that Bankers Trust's commercial paper placement activities did not constitute "selling," "underwriting," or "distributing" commercial paper securities for purposes of the Glass-Steagall Act, which generally prohibits banks from underwriting or dealing in securities. The SIA contends that the Board's interpretation of the Act is

incorrect as a matter of law and that its ruling must therefore be set aside. The Board, along with defendant-intervenor Bankers Trust (hereinafter referred to collectively as "defendants"), oppose the SIA's motion for summary judgment and have filed cross motions for summary judgment. For the reasons set forth below, the Court concludes that Bankers Trust's commercial paper activities do indeed violate the strictures of the Glass-Steagall Act and that the Board's contrary ruling must therefore be invalidated.

I. BACKGROUND

The Court is well-acquainted with the parties to this action and their dispute, which began in 1979 and has already wound its way once through the entirety of the federal judicial system. In January 1979, plaintiff SIA and A.G. Becker, Inc., a commercial paper dealer, requested that the Board prohibit Bankers Trust from selling commercial paper issued by companies not related to the bank,[1] claiming that such sales were prohibited by certain provisions of the Banking Act of 1933, commonly referred to as the Glass-Steagall Act. Section 16 of the Act, 12 U.S.C. § 24 Seventh (1982), bars national banks from dealing in securities, except purchases and sales made, without recourse, upon the order and for the account of bank customers, while section 21, 12 U.S.C. § 378(a)(1) (1982), prohibits banks from "issuing, underwriting, selling or distributing" securities. Responding to the petitions of SIA and

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1 The Court offers, as it did in its previous disposition of this case, the following definition of commercial paper, found in Comment, *The Commercial Paper Market and the Securities Acts*, 39 U. Chi. L. Rev. 362, 363-64 (1972):

> Commercial paper consists of unsecured, short-term promissory notes issued by sales and personal finance companies; by manufacturing, transportation, trade and utility companies; and by the affiliates and subsidiaries of commercial banks. The notes are payable to the bearer on a stated maturity date. Maturities range from one day to nine months, but most paper carries an original maturity between thirty and ninety days. When the paper becomes due, it is generally rolled over—that is, reissued—to the same or a different investor at the market rate at the time of maturity.

Becker in September, 1980, the Board took the position that the financial instruments sold by Bankers Trust—prime quality third-party commercial paper with a maturity of nine months or less, sold in large denominations to sophisticated customers—were not "notes or other securities" for purposes of the Glass-Steagall Act, and that Bankers Trust's sales were therefore legal. Shortly thereafter, Becker and the SIA commenced suit in this Court, seeking review of the Board's conclusion. In a decision dated July 28, 1981, this Court ruled that commercial paper was in fact a "note[ ] or other securit[y]" within the meaning of the Act, and therefore invalidated the Board's decision. *A.G. Becker, Inc.* v. *Board of Governors of the Federal Reserve System*, 519 F. Supp. 602 (D.D.C. 1981). A divided panel of the Court of Appeals reversed that judgment, adopting the Board's reasoning, *A.G. Becker, Inc.* v. *Board of Governors of the Federal Reserve System*, 693 F.2d 136 (D.C. Cir. 1982), but the Supreme Court overturned the Court of Appeal's decision and reinstated this Court's holding that commercial paper is comprehended by the literal language of the statute, and that the inclusion of such financial instruments within the Act's terms is fully consistent with its purposes. *Securities Industry Association* v. *Board of Governors of the Federal Reserve System*, ____ U.S. ____, 104 S. Ct. 2979 (1984) ("*SIA*"). The Supreme Court, however, expressed no opinion as to whether Bankers Trust's placement activities constituted "underwriting," "issuing," "selling" or "distributing" within the meaning of the statute, and therefore remanded the case for determination of that question. *Id.* at ____, 104 S. Ct. at 2992. In an Order dated October 19, 1984, this Court remanded the case to the Board so that it might consider the "underwriting" issue in the first instance.

In order that the contentions of the parties and the conclusions of the Court may be better understood, it is necessary to set out Bankers Trust's activities in some detail. In 1978, the bank first began offering for sale third-party commercial paper, soliciting purchasers through advertisements announcing its placement services. The bank also initiated a marketing campaign aimed at issuers of commercial paper, promising to

perform services competitive with securities dealers. Chief among these services was Bankers Trust's offer to extend short-term credit to commercial paper issuers to cover the unsold portions of any given issue, at interest rates equal to or near the rates borne by the paper. Following the Supreme Court's decision, the Board notified Bankers Trust by letter dated December 3, 1984, that this practice of extending back-up credit to issuers "appears to be the economic equivalent of buying some of the unsold issue with the bank's own funds, an activity that would appear to be prohibited by the [Glass-Steagall] Act." Statement Concerning Applicability of the Glass-Steagall Act to the Commercial Paper Placement Activities of Bankers Trust Company at 3 (June 4, 1985) ("June 4, 1985 Statement"). As this conclusion was based upon Bankers Trust's 1980 placement activities, the Board offered the bank an opportunity to provide information concerning its more recent placement methods, and also solicited comments from interested parties, including, among others, the SIA.

The bank's current activities in the commercial paper market, which are described in the Board's June 4, 1985 Statement and lie at the heart of the present dispute, differ in several material respects from its 1980 placement methods. Bankers Trust still assists issuers in placing their paper with large financial institutions, advising client issuers with respect to the rates and maturities of a proposed issue that are likely to be accepted, soliciting potential purchasers and selling the paper to them. The bank, however, no longer lends short-term funds to issuers at or near the rates of interest of the paper being placed. It does not purchase or repurchase the paper, inventory it overnight, or take any ownership interest in the paper. Nor does the bank make loans on the paper, as it used to, or take the paper as collateral for loans. Finally, the bank enters into no repurchase, endorsement or other guarantee arrangement with purchasers of the paper. June 4, 1985 Statement at 4-5.

In its June 4, 1985 Statement, the Board concluded that Bankers Trust is not engaged in "distributing" or "underwriting" securities under section 21 of the Glass-Steagall Act, because its current placement activities do not involve public

offerings as that term is defined under the federal securities law. While Bankers Trust is involved in "selling" securities, the Board found that the bank does so without recourse, upon the order and for the account of its customers, and that its sales therefore fall within the "permissive phrase" of section 16 of the Act. Finally, the Board concluded that the bank's placement activities will not give rise to the hazards and financial dangers that the Glass-Steagall Act was designed to prevent, and that they therefore fall outside the scope of the Act.

Following the Board's decision, the parties filed the cross motions for summary judgment now before the Court, and various *amici* filed supporting memoranda. Oral argument on the motions was held on September 19, 1985.

II. DISCUSSION

The Board, of course, is the agency charged with regulating the national banking system, and as such has primary responsibility for implementing the Glass-Steagall Act. *SIA*, ____ U.S. at ____, 104 S. Ct. at 2983. Courts, therefore, are to "accord substantial deference to the Board's interpretation of that Act whenever its interpretation provides a reasonable construction of the statutory language and is consistent with legislative intent." *Securities Industry Ass'n* v. *Board of Governors*, ____ U.S. ____, 104 S. Ct. 3003, 3009 (1984) ("*Schwab*"). The Supreme Court has made clear, however, that the deference owed is not so great as to convert judicial review into a rubber stamp for Board decisions. Under the standard enunciated in *SIA*, courts are to determine for themselves the congressional intent underlying a given banking statute, and " 'must reject administrative constructions of [that] statute . . . that are inconsistent with the statutory mandate or that frustrate the policy that Congress sought to implement.' " *SIA*, ____ U.S. at ____, 104 S. Ct. at 2983 (quoting *Federal Election Comm'n* v. *Democratic Senatorial Campaign Comm'n*, 454 U.S. 27, 32 (1981)).

The Glass-Steagall Act was passed in 1933, in response to the banking collapse that ushered in the Great Depression of the 1930's. The Act reflected the widely-held view that the depth of

the nation's financial crisis was attributable in large measure to the extensive participation of commercial banks in speculative investment banking activities. In order to restore public confidence in commercial banks as depository institutions, and to prevent future financial disasters, Congress sought "[t]hrough flat prohibitions . . . to 'separat[e] as completely as possible commercial from investment banking.' " *SIA*, ____ U.S. at ____, 104 S. Ct. at 2985 (quoting *Board of Governors* v. *Investment Company Institute*, 450 U.S. 46, 70 (1981) ("*ICI*")). The two principal prohibitions designed to effect such a separation are found in sections 16 and 21 of the Act. Section 21 prevents persons or firms involved in investment banking activities from engaging in commercial banking by making it illegal for any person "engaged in the business of issuing, underwriting, selling or distributing . . . stocks, bonds, debentures, notes or other securities to engage in the business of receiving deposits . . . ." 12 U.S.C. § 378.[2] Section 16 enforces this prohibition from the other side of the equation. It provides that "[t]he business of dealing in securities and stock by [member banks] shall be limited to purchasing and selling such securities and stock without recourse, solely upon the order, and for the account of, customers, and in no case for its own account. . . ." 12 U.S.C. § 24 Seventh. As Bankers Trust is a member bank in the business of receiving

2 Section 21 provides, in pertinent part:

it shall be unlawful—

(1) For any person, firm, corporation, association, business trust or other similar organization, engaged in the business of issuing, underwriting, selling, or distributing, at wholesale or retail, or through syndicate participation, stocks, bonds, debentures, notes, or other securities, to engage at the same time to any extent whatever in the business of receiving deposits subject to check or to repayment upon presentation of a passbook, certificate of deposit, or other evidence of debt, or upon request of the depositor: *Provided*, That the provisions of this paragraph shall not prohibit national banks or State banks or trust companies (whether or not members of the Federal Reserve System) or other financial institutions or private bankers from dealing in, underwriting, purchasing, and selling investment securities, or issuing securities, to the extent permitted to national banking associations by the provisions of section 24 of this title . . . .

deposits, both sections apply to its activities. *SIA*, ____ U.S. at ____, 104 S. Ct. at 2986.

A. *Bankers Trust's Activities As "Selling" Commercial Paper*

There can be no dispute that Bankers Trust "sells" commercial paper on behalf of issuers, and that its activities are therefore embraced by the literal terms of section 21, which broadly prohibits banks from "selling" securities. In its June 4, 1985 Statement, the Board took the position that because section 16 authorizes banks to engage to some extent in selling securities, section 21 should not be read as prohibiting sales activities expressly permitted by section 16. June 4, 1985 Statement at 9. Plaintiff challenges this construction of the Act. Noting that the terms of the statute are to be given their literal meaning, *ICI*, 450 U.S. at 65, plaintiff argues that the term "selling" comprehends all sales activities—be they principal or agency transactions, private or public sales and thus carves out no exception for sales authorized under section 16. Bankers Trust's activities are unlawful if prohibited by either section of the Act, *SIA*, ____ U.S. at ____, 104 S. Ct. at 2986, plaintiff claims, and thus because they fall within the plain meaning of section 21's broad prohibition, the bank's activities are illegal.

In advancing such an argument, however, the SIA ignores the Supreme Court's observation that sections 16 and 21 "seek to draw the same line." *Id.* Indeed, section 21 expressly states that its provisions "shall not prohibit national banks . . . from dealing in, underwriting, purchasing, and selling investment securities to the extent permitted by the provisions of section 24 of this title." 12 U.S.C. § 378(a)(1). Paragraph seventh of Section 24, of course, is the codification of section 16 of the Glass-Steagall Act. Thus, section 21 would appear to incorporate by express reference the sales exception created by section 16. Even were this not the case, plaintiff's construction of the Act flies in the face of the maxim that the provisions of a statute should be read consistently with one another in order to give meaning to each, since Congress is presumed not to draft

superfluous or insignificant language. *United States* v. *Menasche*, 348 U.S. 528, 538-39 (1955); *Zeigler Coal Co.* v. *Kleppe*, 536 F.2d 398, 406 (D.C. Cir. 1976). Under plaintiff's reading of the Act, section 16's carefully drafted exception to the general prohibition on the sale of securities would be rendered completely nugatory by section 21. Congress most certainly could not have intended such a result. The Court, therefore, finds that the Board's construction of section 21, which gives effect to section 16's permissive phrase, is both consistent with congressional intent and reasonable.

1. *Section 16's Permissive Phrase*

The relevant inquiry then, is whether Bankers Trust's sales activities fit within section 16's permissive phrase. In the Board's view, the bank's current placement methods satisfy each of the criteria set out in the section: the Board concluded that (1) the bank does not purchase the commercial paper for its own account or extend credit to the issuer in a manner that is the functional equivalent of purchasing the paper; (2) the bank does not assume any market risk for, or in any way guarantee, the paper it places; and finally (3), the bank places the paper solely upon the order of its customer, the commercial paper issuer. June 4, 1985 Statement at 10. Plaintiff takes issue with each of these conclusions.

The first of these disputed findings raises several troublesome questions, particularly in light of the procedural posture of the case. In concluding that Bankers Trust does not purchase the securities for its own account, the Board relied upon the bank's submission that it no longer provides back-up credit to issuers to cover unsold portions of a commercial paper issue, and that where the bank does provide credit to an issuer, it does so as part of its ordinary commercial lending functions, in a manner unrelated to and independent of the bank's efforts to place the issuer's paper. June 4, 1985 Statement at 11-13. Indeed, the Board explicitly stated that its analysis of the bank's activities "is premised on the assumption that Bankers Trust does not provide its letter of credit to support a particular issue of commercial paper placed by the bank." *Id.* at 14

n.13. As plaintiff notes, banks have a strong incentive to offer such credit to issuers, not only because they earn a fee on the loan, but because the credit enhances the marketability of the paper the bank is attempting to sell. *See SIA*, ____ U.S. at ____, 104 S. Ct. at 2989. The Board's answer to this concern, however, is to further assume that where the bank extends credit to an issuer, "it would do so under different terms, at different times, and for different purposes"; that the bank would keep appropriate records to demonstrate the independence of the loan and the issue of commercial paper; and that the bank would assure itself that any funds advanced would not be used to pay any paper placed by the bank or to cover any unsold portion of an issue. June 4, 1985 Statement at 13. Plaintiff seriously challenges the validity of these assumptions, pointing to several advertisements and commercial paper rating service evaluations explicitly acknowledging that Bankers Trust backed certain issues through letters of credit.[3] These public announcements appeared prior to the Board's ruling and have continued since, *see* n.3 *supra*; the most recent prompted a letter from the Board to the Court, explaining that the transaction at issue appeared to have been initiated prior to both the Board's ruling and the Board's December 1984 letter to the bank, and that in any event, the Board was investigating the matter and would take remedial action if necessary to ensure that the bank is no longer extending credit to back the paper it

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3 Plaintiff attached to its Memorandum in Opposition to Defendants' Cross-Motion for Summary Judgment and in Support of Plaintiff's Motion for Further Summary Judgment, a "tombstone" advertisement that appeared in the February 28, 1985 *Wall Street Journal* which stated that Bankers Trust "initiated this program, provides letter of credit support, and acts as financial advisor, trustee and exclusive sales agent" for Renault Industrias Mexicana's commercial paper program. In a letter to the Court dated October 10, 1985, plaintiff's counsel also attached *Moody's Commercial Paper Record* (October 1985) which rates the same commercial paper as prime "based solely on the support provided by a letter of credit issued by Bankers Trust Company." At oral argument, however, counsel for Bankers Trust stated unequivocally that the bank no longer bears letter of credit risk on the Renault Industrias Mexicana transaction. Transcript of September 19, 1985 hearing at 51.

places. Letter from Richard N. Ashton, counsel for the Board, to the Court (November 12, 1985).

This case, of course, is presently before the Court on cross-motions for summary judgment. Were the Court otherwise persuaded that the Board's ruling is correct and should be upheld, these public announcements, particularly those published since the Board's ruling, would preclude summary judgment for defendants, as they clearly raise questions of material fact. There can be no doubt that the Board's assumptions regarding the bank's lending practices are material to the case —they lie at the heart of the Board's determination that the bank no longer purchases the securities for its own account or otherwise assumes any market risk in connection with the paper. The public announcements cast serious doubt upon the validity of those assumptions and raise a host of factual questions—*e.g.*, do the announcements refer to transactions pre-dating the Board's ruling or its letter of December 1984? can the Board adequately monitor the bank's lending practices to assure compliance with the ruling? could or should the bank have withdrawn the commercial paper issues in question following the Board's December 1984 letter?—that this Court is not prepared to answer on the basis of declarations made in the parties' papers. Because the Court is of the view that the Board's ruling is invalid for other reasons, however, it need not address such questions here.[4] For present purposes, therefore, the Court accepts as valid the Board's conclusion that Bankers Trust does not purchase, through loans or otherwise, the commercial paper it places.

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4 The public statements, and the Board's letter of November 12, 1985, in particular, are significant not only for their bearing on the validity of the Board's assumptions, but because they shed considerable light on the nature of the Board's ruling. In the previous round of this litigation, the Supreme Court admonished the Board for attempting to erect a regulatory framework under the Glass-Steagall Act, where the Act itself established flat prohibitions. "Congress," the Court stated, "rejected a regulatory approach when it drafted the statute, and it has adhered to that rejection ever since." *SIA*, ____ U.S. at ____,104 S. Ct. at 2988. The Board's recent letter strongly suggests that it is again attempting to regulate the commercial paper placement activities of Bankers Trust through bank examinations and investigations.

Plaintiff next contends that regardless of whether the bank actually purchases the paper it places, it nevertheless assumes certain market risks in connection with its sale of the paper and therefore fails to satisfy the "without recourse" requirement of section 16. This is so, plaintiff argues, because in selling commercial paper the bank makes a number of implied representations concerning the creditworthiness of the paper; breach of these implied representations, plaintiff contends, creates potential liability under the federal securities laws, thereby permitting the purchaser of the paper to seek redress from the bank. This Circuit, however, has already rejected in a different context the SIA's claim that such contingent liability violates the "without recourse" provision of section 16. The ordinary commercial meaning of the phrase "without recourse" simply " 'prohibits banks from assuming the liability of endorser or maker with respect to the securities,' " but does not embrace incidental liability under the securities laws. *Securities Industry Ass'n* v. *Comptroller of the Currency*, 577 F. Supp. 252, 257 (D.D.C. 1983) (quoting *In re Bank America Corp.*, 69 Fed. Res. Bull. 105, 115 n.50 (1983)), *aff'd per curiam*, 758 F.2d 739 (D.C. Cir. 1985). *See also Securities Industry Ass'n* v. *Board of Governors*, 716 F.2d 92, 100 n.4 (2d Cir. 1983) (bank's brokerage activities do not violate section 16 merely because bank faces incidental liability to third party if brokerage customer breaches agreement to buy or sell security), *aff'd*, ____ U.S. ____, 104 S. Ct. 3003 (1984). Thus, if the Board's underlying assumptions about the bank's lending practices are accepted, Bankers Trust sells the commercial paper without recourse for purposes of the Act.

Section 16's final requirement is that the bank sell the securities "upon the order" of its customers. In the Board's view, Bankers Trust's activities comport with this requirement because (1) it is the issuer, not the bank, who decides whether to issue commercial paper and in what amount; (2) the issuer is clearly a customer of the bank; and (3) nothing in the statute requires that the customer have a pre-existing relationship with the bank. June 4, 1985 Statement at 16.

2. *The Act's Legislative History*

Having determined that Bankers Trust's activities fit neatly within the literal language of section 16's permissive phrase, the Board turned to the Act's legislative history, and concluded that the "placement of securities with a limited number of purchasers by a bank, acting solely as agent of an issuer, was not identified as a source of congressional concern." *Id.* at 18 (footnote omitted). The Board noted that nothing in the legislative history specifically prohibits banks from participating in the initial flotation of securities, and thus it found no reason not to apply the statutory language literally. The fact that banks never engaged in such activities prior to passage of the Act, or in the fifty years following its enactment, is in the Board's view insignificant, and simply reflects the previous lack of economic incentive to provide such services. *Id.* at 20.

It is here that the Court parts company with the Board. As plaintiff notes, the Glass-Steagall Act sets out a series of "flat prohibitions," *SIA*, ____ U.S. at ____, 104 S. Ct. at 2985, and it is against this framework that section 16's narrow exception is to be gauged. The Board, by contrast, starts its analysis from an entirely different perspective: rather than asking whether, in view of the statute's prohibitions, the legislative history supports the authorization that the Board has found in section 16, the Board instead looks to see whether there are any statements in the debates or hearings on the bill that demonstrate congressional disapproval of such an authorization. The Board has thus asked the wrong question and in so doing, plaintiff submits, has "transform[ed] a narrow exception addressed to a completely different activity into an expansive authorization that defeats the prohibition intended." Plaintiff's Motion at 26. The Court agrees.

As noted previously, Congress designed the Glass-Steagall Act "to separat[e] as completely as possible commercial from investment banking.' " *SIA*, ____ U.S. at ____, 104 S. Ct. at 2985 (quoting *ICI*, 450 U.S. at 70). Such a separation was necessary, Congress believed, not only to protect bank assets from imprudent securities investments, but also to forestall the

more subtle hazards that arise when a bank is cast in the role of sole promoter for specific securities. In Congress' view "the promotional incentives of investment banking and the investment banker's pecuniary stake in the success of particular investment opportunities was destructive of prudent and disinterested commercial banking and of public confidence in the commercial banking system." *Investment Company Institute* v. *Camp*, 401 U.S. 617, 634 (1971) ("*Camp*"). Senator Bulkley, one of the Act's principal sponsors, noted that

> the banker who has nothing to sell to his depositors is much better qualified to advise disinterestedly and to regard diligently the safety of depositors than the banker who uses the list of depositors in his savings department to distribute circulars concerning the advantages of this, that, or the other investment on which the bank is to receive an originating profit or an underwriting profit or a distribution profit or a trading profit or any combination of such profits.

75 Cong. Rec. 9912 (1932). In addition to the conflicts of interest that result when a bank acts as both promoter of securities and investment adviser to its depositors, Congress feared the promotional pressures that might lead banks to misuse their credit facilities in order to advance their investment banking activities. Thus, Congress expressed concern that banks might extend credit to shore up a company for which they distribute securities; or that banks would be tempted to make imprudent loans either to companies in whose securities they have a promotional stake or to purchasers of those securities; or that banks might pressure companies to which they have made loans to issue securities through the banks' distribution systems. *See SIA*, ____ U.S. at ____, 104 S. Ct. at 2985; *Camp*, 401 U.S. at 633. In short, Congress viewed certain investment banking activities as "fundamentally incompatible with commercial banking" and therefore created "a broad structur[e] that would surround the banking business with sound rules which recognize the imperfection of human nature that our bankers may not be led into temptation, the

evil effect of which is sometimes so subtle as not to be easily recognized by the most honorable man.' " *SIA*, ____ U.S. at ____, 104 S. Ct. at 2985 (quoting Sen. Bulkley, 75 Cong. Rec. 9912).

It is against the backdrop of these congressional concerns that the scope of section 16's sales authorization is to be determined. Given the structure of the statute, that authorization is necessarily a narrow one. Section 21 bans all "selling" of securities by persons who receive deposits, while section 16 bars banks from dealing in securities except for sales and purchases made, without recourse, upon the order and for the account of customers. As the Supreme Court has elsewhere noted, section 16's permissive phrase "accurately describes securities brokerage." *Schwab*, ____ U.S. at ____, 104 S. Ct. at 3011 n.20. It permits banks, acting as agents, to "arrange[ ] the purchase and sale of securities as an accommodation to their customers." *Id.* at ____, 104 S. Ct. at 3008. Thus, in *Schwab*, the Supreme Court upheld a Board decision permitting a bank holding company to acquire a non-banking affiliate engaged in retail securities brokerage, and this Circuit has ruled that national banks may purchase or establish discount securities brokerage subsidiaries. *Securities Industry Ass'n* v. *Comptroller of the Currency*, 577 F. Supp. 252 (D.D.C. 1983), *aff'd per curiam*, 758 F.2d 739 (D.C. Cir. 1985). Retail brokerage activities by banks do not raise the specter of those subtle hazards that the Glass-Steagall Act is designed to prevent: the profits of one selling in the retail or secondary market turn on the volume of shares sold, not on the purchase or sale of a particular security; the broker-bank has no "salesman's stake" in the securities it trades, and it cannot increase its profitability by extending credit to issuers of particular securities, nor by improperly favoring particular securities in the management of depositors' assets. *Schwab*, ____ U.S. at ____, 104 S. Ct. at 3011. Banks had engaged in retail brokerage sales prior to passage of the Act, and Congress, apparently convinced that the evils associated with investment-banking activities did not inhere in such activities, drafted section 16 to permit banks "to purchase and sell investment securities for their customers to

the same extent as heretofore." S. Rep. No. 77, 73d Cong., 1st Sess. 16 (1933) (quoted in *Schwab*, ____ U.S. at ____, 104 S. Ct. at 3008 n.13).

Bankers Trust's placement of commercial paper is of a wholly different character. The bank does not sell in the secondary market as a broker, but assists in the initial flotation of securities in the primary market. It most definitely has a "salesman's stake" in the securities it sells—it earns its fee based on its success in placing a given issuer's paper, and indeed, its ability to attract new customers/issuers depends on how successful it is in marketing its customers securities. Unlike the typical broker, Bankers Trust is not indifferent to the identity of the securities it sells; on the contrary, the profitability of its placement services hinges on "the purchase or sale of *particular* securities." *Schwab*, ____ U.S. at ____, 104 S. Ct. at 3011 (emphasis supplied). The bank is therefore inevitably cast in the role of promoter for specific securities, and precisely those promotional evils that Congress sought to root out of the commercial banking world are present in its activities.

The very history of this litigation, in fact, serves to illustrate the point. From 1978 until, presumably, December 1984, when the Board directed Bankers Trust to discontinue the practice, the bank extended credit to issuers in order to enhance the marketability of its commercial paper.[5] In *Schwab*, by contrast, the Supreme Court found that promotional pressures did not inhere in retail brokerage services because a bank "*cannot* increase [its] profitability by . . . extend[ing] credit to issuers of particular securities." *Id.* at ____, 104 S. Ct. at 3011 (emphasis supplied). Obviously, Bankers Trust can, and for six years did, increase the profitability of its placement services through various credit extensions to issuers. Thus, while retail brokerage services lack certain promotional pressures as a matter of simple economics—*i.e.* because there is no financial

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5 *See, e.g., Moody's Commercial Paper Record* (October 1985) (explaining that Prime-1 rating for Renault Industrias Mexicana S.A. "is based solely on the support provided by a letter of credit issued by Bankers Trust" and "does not necessary reflect the credit worthiness of the issuer in any other issue . . .").

incentive to distort lending practices—the Board had to suggest a number of regulatory guidelines in its June 4, 1985 Statement in order to curb those pressures that are undeniably present in Bankers Trust's activities. Accordingly, the Board assumed that if the bank advances funds or credit to an issuer, it will do so under different terms, at different times and for different purposes, than if the bank meant to support a specific issue of commercial paper; that the bank will keep adequate records to demonstrate the independence of loans from commercial paper issues; and that the bank will monitor loans to issuers to make certain they are not used to cover unsold portions of any issue. June 4, 1985 Statement at 13. It is readily apparent, however, that these safeguards are not and cannot be self-enforcing; indeed, in its November 12, 1985 letter to the Court, the Board admits that an investigation into the bank's credit and lending practices is necessary to determine, nearly one year after its December 1984 letter, if Bankers Trust is extending credit to commercial paper issuers. Such an investigation is a tacit concession that promotional pressures absent from retail brokering arise naturally in sales activities such as Bankers Trust's.

In light of the concerns that prompted passage of the Glass-Steagall Act, the statute's broad prohibitions, the rather limited exception created by section 16, and the promotional pressures that necessarily inhere in Bankers Trust's sales activities, the Board's assertion that there is nothing in the Act's legislative history "indicating that secondary market brokerage activities were the *only* functions intended to be authorized [by section 16] or that the statutory terms should not be read literally," June 4, 1985 Statement at 19 (emphasis in original), rings more than a little hollow. By looking to see only whether the bank's sales activities fit within the literal terms of the Act, and ignoring the structure and spirit of the law, the Board has, as plaintiff suggests, turned the statute on its head. What little legislative history there is concerning the permissive phrase of section 16 indicates that Congress intended to allow banks to continue the traditional retail brokerage services they had provided prior to passage of the Act. Yet the Board finds in this narrow exception authorization for sales activities of a

completely different nature, apparently unheard of in 1933,[6] and fraught with the very promotional pressures Congress found so injurious to commercial banking.

3. *The Board's Analysis of the "Subtle Hazards"*

Perhaps recognizing the unpersuasiveness of its legislative history analysis, the Board elsewhere in its ruling examines the "subtle hazards" that Congress sought to eliminate by passing the Act, and finds that they are not likely to arise when banks sell commercial paper as the agents of issuers. The Board notes, therefore, that while a misuse or distortion of the bank's credit operations "is of particular concern," June 4, 1985 Statement at 39, it concludes that impairment of the bank's objectivity is "not significant" because the bank will take adequate steps to assure that its credit facilities are not improperly used, and because the financial gains from the bank's sales activities are too small in relation to its lending operations to lead the Board to believe that the former will influence the latter. *Id.* at 40. Similarly, the Board does not envisage significant damage to the public's confidence in commercial banks as a result of placement activities such as Bankers Trust's. This is so, in the Board's view, because the investing and depositing public will be fully apprised of the bank's activities and the bank's loans will be independent of its sales operations. Moreover, because the bank sells paper to only a limited number of institutions, it is likely that the investors will amount to only a small fraction of the bank's depositors, and therefore even if they withdraw funds following a loss on commercial paper "the loss of business would not likely have an effect on the bank's safety or soundness." *Id.* at 42. In addition, the sophisticated investors that Bankers Trust sells to are likely, the Board believes, to view any loss on the commercial paper as at

6 In *SIA*, the Court noted that the history of commercial bank involvement with commercial paper prior to the Act's passage is not well-documented, but that to the extent banks did participate, they did so as discounters rather than dealers. ____ U.S. at ____, 104 S. Ct. at 2992. The commercial-banking industry's failure to deal in commercial paper since the Act was passed, the Court observed, suggests that banks understood such activity to be prohibited by the statute. *Id.*

least partly their own fault. *Id.* at 43. Finally, the Board anticipates that the bank's role as disinterested financial adviser to its depositors will not be compromised by its sales operations, and similarly, that the bank is unlikely to pressure its corporate clients into using its placement services. The bank does not purchase commercial paper for its trust department, and, in the Board's view, the promotional incentives inherent in the bank's sales activities are "not significant" and thus unlikely "to subject the bank to this kind of conflict of interest." *Id.* at 46.

The Board's evaluation of the "subtle hazards" issues is flawed in several key respects. To begin with, the Board assumes that the "pecuniary stake" identified by the Supreme Court in *SIA* as the source of impermissible promotional pressures was "undoubtedly linked" to the bank's investment of its own funds in the commercial paper it sold. *Id.* at 35. The fact that Bankers Trust may no longer purchase the paper through loans or credit extensions, the Board believes, eliminates this pecuniary stake altogether. While it is true that some of the congressional concerns discussed by the Supreme Court involved the bank's actual purchase of securities, such activities are hardly the exclusive source of promotional incentives. As noted above, Bankers Trust, as a seller in the primary market, is of necessity a promoter of specific securities. The Board concedes that the commercial paper market is "highly competitive," *id.* at 36, and that Bankers Trust's placement services are "designed primarily to maintain the bank's relationship with its best commercial lending customers, which in the recent past have increasingly sought to satisfy their short-term funding needs in the commercial paper market, rather than through loans from the bank." *Id.* at 37. It is obvious, then, that whether or not the bank purchases the commercial paper, it has a very significant "salesman's stake" in the paper it sells: in order to maintain its relationship with its most important commercial customers, the bank must place securities in a highly competitive market. The promotional pressures in such a situation are self-evident. In the face of these facts, the Board's conclusion that "the promotional incentive inher-

ent in the [bank's] commercial paper activity is not significant," June 4, 1985 Statement at 46, is simply untenable.[7]

In addition, the Board's analysis is premised on the mistaken supposition that Congress sought only to eliminate "likely" hazards or conflicts of interests. The Board acknowledges, for example, that personnel in the bank's credit department will in all likelihood be aware of the bank's role in placing a borrower's paper, thereby recognizing a potential conflict between the bank's role as lender and promoter. Nevertheless, it dismisses this conflict as unlikely. June 4, 1985 Statement at 39-40. Similarly, the Board recognizes that the bank's reputation could be harmed if the issuer of the paper were to default, but concludes that the damage would not be significant. *Id.* at 41-42. In like manner, the Board disposes of several other congressional concerns such as the possible lack of disinterested financial advice to depositors, or the danger that companies might issue paper to raise money in order to repay outstanding loans to the bank. In each case, the Board concedes that such dangers are possible but ultimately unimportant because, in the

7 The Board, in its submissions to this Court, make much of the fact that in *Schwab* the Supreme Court stated in a footnote that "[a]ll these subtle hazards are attributable to the promotional pressures that arise from . . . purchas[ing] and sell[ing] particular investments *on their own account*," _____ U.S. at _____, 104 S. Ct. at 3011 n.23 (emphasis supplied). Defendants read this statement as a determination by the Supreme Court that underwriting alone gives rise to the hazards Congress sought to forestall. Such a reading, however, is unwarranted. To begin with, in *Schwab* the Supreme Court did not have before it activities such as Bankers Trust's here, and thus had no reason to consider the hazards that might arise when banks sell securities in the primary market without actually purchasing them. Moreover, the Court's textual analysis in *Schwab* does not suggest that underwriting is the exclusive source of deleterious promotional pressures. As discussed previously, the Court in *Schwab* identified a number of promotional hazards that were absent from Schwab's activities that are clearly present thus, unlike Schwab, Bankers Trust's profits do depend on the purchase or sale of *particular* securities; and Bankers Trust *could* enhance the profitability of its services by extending credit to issuers of particular securities, *see* note 5 *supra* and accompanying text, or by favoring particular securities in the management of depositors assets. *See Schwab*, _____ U.S. at _____, 104 S. Ct. at 3011.

Board's view, they are unlikely. The Board's assessment of these likelihoods, however, whether accurate or not, simply misses the mark. As the Supreme Court made abundantly clear in *SIA*, Congress drafted the law to eliminate *potential* conflicts of interest, not simply those that were especially likely to occur. Congress, the Supreme Court noted, was concerned "that a bank's salesman interest in an offering '*might* impair its ability to function as an impartial source of credit,' " ____ U.S. at ____, 104 S. Ct. at 2989 (quoting *Camp*, 401 U.S. at 631) (emphasis supplied), and that banks "*might* use their relationships with depositors to facilitate distribution of securities in which the bank has an interest." *Id.* at ____, 104 S. Ct. at 2989-90 (emphasis supplied). In *SIA*, the Board argued that these congressional concerns were not implicated by the bank's activities because of the extremely low rate of default on prime quality commercial paper—*i.e.* that the hazards identified by Congress were not *likely* to arise. The Supreme Court rejected this actuarial analysis in no uncertain terms, stating that "the Act's underwriting prohibition displays no appreciation for the features of a particular issue; the Act just prohibits commercial banks from underwriting any of them." *Id.* at ____, 104 S. Ct. at 2990. Indeed, the Court noted that the law's prohibitions "reflect[ ] Congress' conclusion that the *mere existence* of a securities operation, '*no matter how carefully and conservatively run*, is inconsistent with the best interests' of the bank as a whole." *Id.* at ____, 104 S. Ct. at 2990-91 (quoting remarks of Sen. Bulkley, 75 Cong. Rec. 9913 (1932) (emphasis supplied). Notwithstanding these unequivocal pronouncements, the Board has once again undertaken an *ad hoc* analysis of probabilities and likelihoods. Neither the Act, nor the Supreme Court's explication of the Act, grant the Board a mandate to weigh the likelihood of a given hazard in light of the concerns that prompted passage of the Act. On the contrary, the Act is premised on a recognition of the "imperfection of human nature," and was designed to eliminate all potential conflicts of interest or other hazards so that bankers might not be "led into temptation," no matter how subtle or imperceptible those temptations might be. 75 Cong. Rec. 9912 (remarks of Sen.

Bulkley). Having identified such potential hazards in Bankers Trust's sales activities, the Board was obligated to invalidate those activities.

In sum, the Court finds that Bankers Trust's sales activities do not fit within the narrow authorization provided by section 16. The bank's flotation of securities in the primary market is replete with precisely those pernicious promotional pressures that Congress sought to eliminate from the commercial banking industry. The Board's attempt to shoehorn such sales activity into section 16's permissive phrase, by regulating the most immediate promotional incentives and dismissing the more subtle as unlikely or insignificant, is inconsistent with Congress' desire to separate as completely as possible commercial and investment banking and must therefore be invalidiated.

B. *Distributing or Underwriting Securities*

The Board, having concluded that Bankers Trust's placement of commercial paper constituted authorized "selling" of securities within the meaning of section 16, next analyzed those activities to determine whether the bank was "distributing" or "underwriting" securities for purposes of section 21, which prohibits banks from engaging in such activities. Unlike its ban on "selling," section 21's prohibition on "distributing" or "underwriting" securities is total, because the Act does not provide the narrow exceptions to these statutory terms that section 16 creates for the term "selling." While the Board conceded that Bankers Trust's placement activities are comprehended by the plain meaning of the terms "distributing" and "underwriting," it eschewed the statutory literalism it found so compelling in interpreting section 16's permissive phrase, and instead read the distribution and underwriting prohibitions as applying only to public offerings. In so ruling, the Board relied by way of analogy on the federal securities laws, which exempt certain non-public offerings from registration requirements. Having thus imported exceptions from the securities laws not found in the Glass-Steagall Act itself, the Board determined that Bankers Trust's sales were not directed at the general public, and therefore did not run afoul of the underwriting and

distribution prohibitions. Plaintiff strenuously objects to both the Board's analysis and its conclusions.[8]

1. *Underwriting*

As the Board explained in its ruling, underwriting typically takes one of two forms. In a "firm commitment" underwriting, a person purchases securities from an issuer and then resells them, thereby assuming the risks of fluctuation in the value of the securities. In a "best efforts" underwriting, a person offers securities to third parties as agent for the issuer. 1 L. Loss, *Securities Regulation* 163-72 (2d ed. 1961). As Bankers Trust no longer purchases, either directly or through extensions of back-up credit, the securities it sells (an assumption which, as noted previously, this Court accepts for present purposes) the bank is not engaged in "firm commitment" underwriting. Plaintiff contends, however, that because the bank sells commercial paper as the agent of issuers, and receives a commission for its promotional efforts directly related to its success in placing the paper, it is clearly engaged in "best efforts" underwriting. The Board does not dispute that "best efforts" distribution constitutes underwriting under the federal securities laws, June 4, 1985 Statement at 23 n.23,[9] but maintains that "[t]he terms 'underwriting' and 'distributing,' as described by the Supreme Court in the *Schwab* decision

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8 The Court's determination that Bankers Trust's activities do not fall within section 16's permissive phrase, and are therefore barred by section 21's ban on the "selling" of securities, is sufficient to dispose of this case. Given the prior history of this litigation, however, with its series of reversals, the fact that plaintiff's challenge to the bank's practices is quickly approaching its seventh year and the importance of this matter to the nation's financial markets generally, prudence and justice dictate that the Court address the Board's rulings on the distribution and underwriting issues.

9 In *Schwab*, the Supreme Court noted that "best efforts" distribution is not technically an underwriting, but did not reach the question of whether such distribution constitutes underwriting for purposes of the Glass-Steagall Act, since such activity was not before the Court. ____ U.S. at ____, 104 S. Ct. at 3010 n.17. In its ruling, the Board acknowledged, however, that it is well-settled that "best efforts" distribution is underwriting for purposes of the federal securities laws.

and as defined in the Securities Act of 1933, typically refer to the process by which securities are offered to the public." *Id.* at 21.

It is true, as the Board claims, that the term "underwriting" commonly refers to the distribution of securities to the public. Thus, in *Schwab*, the Supreme Court noted that "[i]n the typical distribution of securities, an underwriter purchases securities from an issuer . . . . [and distributes] . . . these securities to the public." ____ U.S. at ____, 104 S. Ct. at 3010 n.17. In a "best efforts" underwriting, the Supreme Court observed, "large blocks of specific issues of securities are offered to the public by the investment banker acting as agent for the issuer." *Id. See also* 1 L. Loss, *Securities Regulation* 164 (2d ed. 1961) (in "firm commitment" underwriting, issuer sells to underwriter, who sells to dealers, who in turn sell to public); Securities Act Rule 144, 17 C.F.R. § 230.144 (preliminary note) (underwriter includes investment banker who arranges for public sale of issuer's securities, as well as nonprofessionals who act as link in chain through which securities brought to public). Noting that in *SIA* the Supreme Court looked to the federal securities laws to determine the meaning of the phrase "notes, or other securities" in the Glass-Steagall Act, the Board sees "no convincing reason why this same principle should not apply in construing the terms underwriting and distributing in sections 16 and 21." Defendants' Motion for Summary Judgment at 26.

The difficulty with the Board's argument is that while both statutes were designed to prevent the abuses that precipitated the Great Depression, the two attack different problems and as a result have differing objectives. The federal securities laws were enacted "to prevent fraud and to protect the interests of *investors*." *United Housing Foundation, Inc.* v. *Forman*, 421 U.S. 837, 849 (1975) (emphasis supplied). Thus, the public or private nature of a securities offering is of crucial importance under the federal securities laws, since a private distribution does not implicate one of the securities laws' core concerns: protecting the relatively unsophisticated, nonprofessional, *public* investor. The Glass-Steagall Act, on the other hand, was designed to preserve the integrity of the commercial banking industry by eliminating the potential conflicts of interest that

arise when banks act as promoters of specific securities. Those conflicts of interest arise regardless of whether the bank engages in a best efforts underwriting campaign aimed at the general public, or sells only to large institutional investors; the promotional pressures which inhere in such activities are in no way diminished by the fact that the bank places commercial paper with the financially sophisticated.[10] The Supreme Court recognized as much in *SIA*, when it rejected the Board's earlier argument that commercial paper is not a note or other security because it is sold only to sophisticated investors. The Court noted that

> the Act leaves little room for such an *ad hoc* analysis. In its prohibition on commercial bank underwriting, the Act admits of no exception according to the particular investment expertise of the customer. The Act's prohibition on underwriting is a ***flat prohibition that applies to sales to both the knowledgeable and the naive.***

____ U.S. at ____, 104 S. Ct. at 2991 (emphasis supplied).[11]

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10 Indeed, to the extent that the sophistication of the purchaser is relevant at all under the Glass-Steagall Act, it would appear that sales to financially astute investors in what the Board concedes is a highly competitive market would increase the promotional pressures on the bank. Such investors purchase on the basis of thorough financial analysis rather than advertising slogans, and would therefore be more likely to purchase securities that are backed by the bank's own credit, *see* note 5 *supra*, thereby increasing the bank's economic incentives to enhance the marketability of specific issues through distortions of its credit practices, however subtle or seemingly innocuous.

11 In its ruling, the Board dismissed the importance of this observation by the Supreme Court by noting that, had the Court determined that all placement activities involving a limited number of investors were barred by the Act, "it would have been unnecessary for the Court to remand the case for a ruling on the underwriting issue." June 4, 1985 Statement at 27. Such an observation, however, is hardly an adequate substitute for a principled analysis of the public/private distinction which the Board draws yet fails to justify in light of the Act's concerns. Indeed, were the Board's logic accepted, Bankers Trust's prior practice of extending back-up credit to issuers could also be upheld, since the Supreme Court did not invalidate such practices outright, but instead remanded the case. The Board obviously found the Court's statements concerning the bank's credit practices control-

In short, the federal securities laws do not provide the compelling analogy the Board finds in them. Bankers Trust's sales activities are a form of best efforts underwriting aimed at large institutional investors, and accordingly fall within section 21's prohibition on underwriting. The Board's attempt to narrow the reach of this statutory language by importing limitations found in the securities laws is simply unpersuasive in light of the differing objectives of the Glass Steagall Act, and the fact that the hazards which prompted passage of that Act are just as likely to occur in sales to private institutions as in sales to the general public.

2. *Distribution*

The Board's conclusion that Bankers Trust has not engaged in prohibited distribution of securities is equally flawed. Indeed, its interpretation of this particular statutory term highlights the inconsistency of its analysis. The Board states that the term "distribution" has been "traditionally . . . viewed as synonymous with a public offering of securities," (June 4, 1985 Statement at 24 (footnote omitted)), and notes that "section 4(2) of the Securities Act (15 U.S.C. § 77d(2)) exempts from the registration and prospectus delivery requirements of the [securities laws] those transactions that do not involve a public offering." *Id.* The Board then goes on to find that Bankers Trust does not engage in a public offering of commercial paper "in the ordinary sense of the term," and therefore does not distribute securities for purposes of the Glass-Steagall Act.

In so ruling, however, the Board fails to account for a significant difference between the two statutes: the Securities Act contains an express exemption for securities distribution through a non-public offering, while the Glass-Steagall Act provides no similar qualification. This discrepancy is significant in at least two respects. First, it indicates that, contrary to what the Board might believe, the term "distribution" in the

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ling and advised the bank to discontinue them. It offers no reasoned explanation as to why those Supreme Court observations are to be given the weight of law, while the Court's statements concerning the nature of the purchasers can be disregarded as inconsequential dicta.

Securities Act does not mean only "public offerings"; if that were true, then the exemption for non-public offerings would be entirely superfluous, since by definition such offerings would not be "distributions," and thus would not be covered by the statute in the first place.[12] Second, the Securities Act exemption demonstrates that Congress was aware of the sometimes different nature of public and non-public distributions of securities, and that when it deemed those differences relevant to a given statute's purpose, it drew appropriate distinctions between the two types of offerings. The Glass-Steagall Act contains no such distinctions, however, compelling the conclusion that the statute prohibits banks from *all* distributions, be they public or non-public. In light of these different statutory structures, the Board's attempt to create an exemption for non-public distributions where none was provided nor apparently intended, simply cannot be upheld.

The Board's efforts to engraft the Securities Act exemption onto the Glass-Steagall Act fail for yet another reason. Having limited the unqualified terms of the Glass-Steagall Act by analogizing to the securities laws, the Board immediately encounters difficulty because Bankers Trust's activities do not satisfy all the requirements of the Securities and Exchange Commission's ("SEC's") Regulation D, which sets out the conditions that must be met in order for an offering to qualify for the private placement exemption of the Securities Act.[13] Forced to back away from its "compelling analogy" and to acknowledge that the Glass-Steagall Act and securities laws were designed to accomplish different objectives, the Board concedes that the interpretation of terms used in the Securities

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12 The Securities and Exchange Commission ("SEC"), the agency charged with primary responsibility for interpreting and enforcing the securities laws, has rejected the view that no distribution occurs simply because an offering is exempt from registration under the Securities Act. *See* Securities Exchange Act Release No. 34-22205, 50 Fed. Reg. 28385, 28392 n.58 (July 12, 1985).

13 The bank advertises its services, thereby violating SEC Rule 502(c) which prohibits general solicitation. 17 C.F.R. § 230.502(c). The bank also places no restrictions on the resale of the paper it sells, violating Rule 502(d). 17 C.F.R. § 230.502(d).

Act should not be controlling for all purposes of the Glass-Steagall Act. June 4, 1984 Statement at 24-25. Having recognized the different purposes of the two statutes, however, the Board does not then ask whether the public/non-public distinction which it finds in the securities laws is relevant to the Glass-Steagall Act. Instead, it dismisses those provisions of Regulation D that Bankers Trust fails to satisfy as not "germane to the core concerns of the . . . Act." *Id.* at 31. This pick-and-choose approach to statutory construction is insupportable. The Board cannot have it both ways, drawing on those provisions of the securities laws that support its decision and rejecting other, less favorable features of those laws as irrelevant. Had the Board looked to see whether the non-public exemption was "germane" to the Glass-Steagall Act, it would have found, as the Court noted previously, that the promotional pressures Congress sought to eliminate are equally present in non-public as well as public distributions. The limitations the Board attempts to impose on the terms of the statute are not only not germane to the Act, they are inconsistent with its core concerns. The Board, however, only inquired into the relevance of those provisions that ran counter to its conclusions, thus undermining the validity of its decision.[14]

Moreover, the Board once again looked to the nature of the purchasers in order to determine whether Bankers Trust is engaged in impermissible distribution of securities. As noted above, the Supreme Court has rejected this consideration as irrelevant to the Glass-Steagall Act, which bars banks from all distributions, and draws no distinctions based on the investment expertise of those to whom the securities are offered. *SIA*, ____ U.S. at ____, 104 S. Ct. at 2991. The rejection is

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14 In addition to illustrating the inconsistency of its analysis, the Board's dismissal of certain portions of Regulation D raises serious questions concerning the respective roles of the Board and the SEC in regulating the securities industry. Congress gave the Board no regulatory authority under the Glass-Steagall Act, *SIA*, ____ U.S. at ____, 104 S. Ct. at 2989, and extensive rule-making authority to the SEC under the Securities Act of 1933. The Board in its ruling not only authorizes bank securities operations, it also appropriates the SEC's authority to define what constitutes a "private placement" of securities. It is extremely doubtful that Congress could have envisioned any such regulatory reversal.

perfectly consistent with the Act's purposes, for as discussed previously, the promotional incentives that inhere in Bankers Trust's sales are as great, if not greater, than the pressures that would arise if the banks were to sell securities to the general public. *See* note 10, *supra* and accompanying text; *see also A.G Becker, Inc.* v. *Board of Governors*, 693 F.2d 136, 154 (D.C. Cir. 1982) (Robb, J., dissenting), *rev'd*, ____ U.S. ____, 104 S. Ct. 2979 (1984) (bank depositors who are financially able to purchase commercial paper in large denominations likely to be among bank's most important clientele; loss of their goodwill due to losses on paper sold by bank could be detrimental to bank's operations). The Board's reliance on this feature of the bank's activities, therefore, provides no support for its conclusion that Bankers Trust does not engage in distributing securities.

Finally, the Board's determination that the bank's activities do not constitute distribution of securities within the meaning of the Glass-Steagall Act reveals again the regulatory approach the Board has adopted. Commenters before the Board argued that because of the short-term maturity of the paper the bank sells, Bankers Trust will be forced to assist in "rolling over" the paper, and therefore its sales efforts cannot realistically be viewed as one-time private placements of securities. In response, the Board stated that the frequent nature of these activities, standing alone, does not necessarily convert a private offering into a public one, and went on to add that "if the bank's activities become directed toward marketing securities to an ever-broadening class of customers, the character of the offering could eventually change from nonpublic to public and the provisions of the Act could then apply." June 4, 1985 Statement at 32. Not surprisingly, the Board offers no suggestion as to how it will determine if and when the bank's marketing efforts have crossed the magic threshold from private to public offerings. Whatever criteria the Board will apply, they certainly will not derive from the statute itself, since the Act draws no distinction between public and private distributions. The Board therefore will have to draft guidelines or rules to demarcate the boundaries between permissible and imper-

missible offerings of securities, and in addition, will be forced to monitor the sales activities of banks to assure adherence to such guidelines.

The Supreme Court, however, has made clear that "[a]lthough . . . guidelines may be a sufficient regulatory response to . . . potential problems, Congress rejected a regulatory approach when it drafted the statute, and it has adhered to that rejection ever since." *SIA*, ____ U.S. at ____, 104 S. Ct. at 2988. In addition, Congress has consistently "continued to withhold from the [Board] the authority to issue regulations concerning 'securities activities of National Banks under the Act.' " *SIA*, ____ U.S. at ____, 104 S. Ct. at 2989 (quoting Depository Institutions Deregulation and Monetary Control Act of 1980, § 708, 94 Stat. 188, 12 U.S.C. § 93a). Once again the Board has run afoul of these unequivocal admonitions. While the Board insists that it is not regulating banks but simply interpreting the statutory terms, its interpretation raises a host of difficulties that can only be addressed through guidelines or regulations. Congress designed the Act as a series of flat prohibitions, obviating the need for regulation. That the Board's ruling converts these clear statutory commands into sliding scale prohibitions necessitating guidelines and agency oversight simply underscores the invalidity of the Board's decision.

In sum, the Court concludes that Bankers Trust is engaged in underwriting and distributing securities for purposes of the Glass-Steagall Act. The Board's attempt to superimpose the private placement exemption of the securities laws onto the Glass-Steagall Act is simply inconsistent with the Act's purpose, as the subtle hazards that Congress intended to forestall are equally present in public and private offerings of securities. The Board's ruling on this issue must therefore also be invalidated.

III. CONCLUSION

The Glass-Steagall Act was enacted over 50 years ago, in response to a financial collapse the likes of which the nation had never before witnessed, nor, fortunately, has it experienced since. It may well be that as the memory of that event recedes from the national consciousness, the concerns which prompted passage of the Act in those stark times appear in retrospect to be less pressing or important than the 1933 Congress envisioned, and the prohibitions Congress drafted may seem today to be unnecessarily restrictive. The commercial banking industry apparently believes so, and has been lobbying Congress to change the law for some time now. To date, the nation's elected representatives have not seen fit to do so. In the face of this congressional inaction, it is not for this court or the Board to alter the law. Yet, the Board would effectively reform the Act under the guise of interpreting it, by attempting to regulate and minimize the very promotional hazards that Congress sought to permanently eliminate from commercial banking. Indeed, Federal Reserve Board Chairman Paul Volcker recognized as much in his concurring statement, in which he wrote that

> a more straightforward way of proceeding would be to obtain legislative authorization for banks to deal in and act as agents for the distribution of commercial paper. Congressional action is needed in order to provide a firm foundation of specifically applicable new law for the conduct of this activity, as well as to provide the Board with full authority to establish the necessary prudential framework.

June 4, 1985 Statement, Concurring Statement of Chairman Volcker at 3. Congress has not yet provided such legislation, nor granted the Board the authority it attempts to assert through its ruling. Until such time as Congress acts, the Board may not give its blessings to Bankers Trust's activities, nor regulate those activities in an effort to minimize the hazards they present.

For all the foregoing reasons, therefore, plaintiff's Motion for Further Summary Judgment be, and it hereby is, granted. The Federal Reserve Board's June 4, 1985 Statement, permitting banks to sell third-party commercial paper, be, and it hereby is, invalidated as inconsistent with the Glass-Steagall Act.

SO ORDERED.

/s/ Joyce Hens Green

JOYCE HENS GREEN
United States District Judge

February 4, 1986

Federal Reserve Press Release and Statement, June 4, 1985

FEDERAL RESERVE PRESS RELEASE

For immediate release June 4, 1985

The Federal Reserve Board today issued a Statement on the commercial paper activities of Bankers Trust Company of New York. The Board decided that these activities, as described in the Statement, do not constitute selling, underwriting or distributing securities within the meaning of the Glass-Steagall Act.

The Board's findings were contained in a statement that was filed today with the U.S. District Court for the District of Columbia. In a June 1984 decision, *Securities Industry Association* v. *Board of Governors (Bankers Trust)*, the Supreme Court ruled that the commercial paper that Bankers Trust places with investors on behalf of issuers unrelated to the bank is a security for purposes of the Glass-Steagall Act, which generally prohibits banks from underwriting or dealing in securities.

The Court, however, expressed no opinion as to whether the bank's method of placing the commercial paper constitutes "selling," "underwriting," or "distributing" within the meaning of the Act. This issue was subsequently remanded to the Board for resolution.

In the statement detailing its decision, the Board said:

> After reviewing all of the relevant facts of record, the Board concludes that Bankers Trust's placement of commercial paper as described in this Statement does not constitute the 'selling,' 'underwriting', or 'distributing' of commercial paper securities for purposes of the Act.

A copy of the Board's statement is attached.

Attachment

FEDERAL RESERVE SYSTEM

STATEMENT CONCERNING APPLICABILITY OF THE GLASS-STEAGALL ACT TO THE COMMERCIAL PAPER PLACEMENT ACTIVITIES OF BANKERS TRUST COMPANY

In *Securities Industry Association* v. *Board of Governors (Bankers Trust)*, 104 S. Ct. 2979 (1984) ("*Bankers Trust*"), the Supreme Court ruled that the commercial paper that Bankers Trust Company, New York, New York ("Bankers Trust"), a state member bank, places with investors on behalf of issuers unrelated to the bank is a security for purposes of the Glass-Steagall Act, which generally prohibits banks from underwriting or dealing in securities. The Court expressed no opinion with respect to whether the bank's method of placing the commercial paper constitutes "selling," "underwriting," or "distributing" within the meaning of the Act. This issue was subsequently remanded to the Board for resolution. At the Board's request, Bankers Trust has submitted a description of its current commercial paper placement methods, arguing that such methods are consistent with the Act. The Securities Industry Association ("SIA") and others have submitted comments contending that the bank's activities constitute forbidden marketing practices under the Act.

I. *Background*

In January 1979, the SIA, a national securities industry trade association, and A. G. Becker Inc., a dealer in commercial paper, petitioned the Board to prohibit Bankers Trust from selling commercial paper issued by companies not related to the bank, alleging that Bankers Trust's commercial paper activities violated the Glass-Steagall Act.[1] In September 1980,

1 Commercial paper refers to unsecured, short-term (maturity of less than nine months), large denomination promissory notes. Such paper is generally issued to finance seasonal or other current needs and is purchased by large financially sophisticated purchasers, such as money market mutual funds, bank trust departments, insurance companies, pension funds, non-

the Board issued a statement in response to the petitions of SIA and Becker. The statement explained the Board's view that the commercial paper being placed by Bankers Trust was not a security for purposes of the Glass-Steagall Act and, therefore, was not subject to the Act's prohibitions against underwriting and dealing in securities.

The SIA and Becker sought judicial review of the Board's September 1980 statement. In June 1984, the Supreme Court overturned the Board's ruling on the status of commercial paper under the Glass-Steagall Act, and remanded the case for further proceedings, expressing no opinion as to whether the commercial paper activity of Bankers Trust constitutes "underwriting" or similar activities within the meaning of the Act. *Bankers Trust*, 104 S. Ct. at 2992 n.12. By order dated October 19, 1984, the United States District Court for the District of Columbia remanded the case to the Board for consideration of the "underwriting" issue left undecided by the Supreme Court.

By letter dated December 3, 1984, the Board advised Bankers Trust that the Board has substantial reason to believe that the bank's commercial paper activities, as conducted at the time of the Board's 1980 statement, would constitute the selling or underwriting of commercial paper securities within the meaning of the Glass-Steagall Act. In particular, the Board stated that the bank's practice of extending short-term credit to issuers of commercial paper placed by the bank to cover unsold portions of the issue at rates of interest equal to or near the rates borne by the commercial paper appears to be the economic equivalent of buying some of the unsold issue with the bank's own funds, an activity that would appear to be prohibited by the Act. Since these tentative conclusions were premised on Bankers Trust's 1980 activities, the Board provided the bank with an opportunity to provide information concerning its current commercial paper activities and afforded represent-

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profit corporations, and nonfinancial corporations. Pursuant to section 3(a)(3) of the Securities Act of 1933, issuers that place commercial paper with sophisticated purchasers in the recognized market do not register the paper under the Act but instead rely on the exception provided by that section. 15 U.S.C. § 77c(a)(3).

atives of the securities industry and other interested parties an opportunity to submit additional or supplemental views.

On January 17, 1985, Bankers Trust submitted a description of its current commercial paper activities, which differed from the bank's prior activities, together with arguments that its modified method of placing commercial paper is consistent with the Glass-Steagall Act. On March 4, 1985, the SIA, Merrill Lynch Money Markets, Inc. (the successor to A. G. Becker), and Goldman Sachs & Co., submitted comments in opposition to Bankers Trust's views. The office of the Comptroller of the Currency ("OCC"), the New York Clearing House Association, the Dealer Bank Association, five banks, and a number of customers of Bankers Trust's commercial paper services submitted comments generally supporting the lawfulness of the services.

According to the description of its activities in the material submitted to the Board, Bankers Trust's current method of placing commercial paper differs significantly from its prior method. As before, the bank acts as agent and adviser in assisting issuers to place their commercial paper with a limited number of institutions, such as banks, insurance companies, mutual funds, and nonfinancial businesses. Bankers Trust advises its client commercial paper issuers with respect to the rates and maturities of a proposed commercial paper issue that are likely to be accepted in the market. If the client wishes to issue commercial paper, Bankers Trust solicits potential institutional purchasers and, acting as the agent of the issuer, places the paper with the purchasers.

However, Bankers Trust has discontinued its prior practice of lending short-term funds to issuers of paper the bank places, at or near the rate of interest of the commercial paper being placed, taking back a commercial paper note. Neither Bankers Trust nor any affiliated company purchases or repurchases commercial paper placed by the bank. The bank does not inventory commercial paper overnight, takes no ownership interest in the paper being placed, and, contrary to its prior practice, does not make loans on the paper it places or otherwise take the paper as collateral for loans. Bankers Trust

enters into no repurchase agreement, endorsement, or other guarantee arrangement with the purchasers of commercial paper placed by the bank.

Bankers Trust places commercial paper only with a limited number of institutions; the bank does not place any paper with individuals.[2] The bank states that it makes no general solicitation or advertisement to the public with respect to specific issues of commercial paper, and paper placed by the bank is not purchased by the general public.

II. *The Statutory Framework*

The Banking Act of 1933 contains four provisions (usually referred to collectively as the Glass-Steagall Act) that prohibit participation by banks and affiliates of banks in specified securities activities. The provisions involved here are sections 16 and 21 of the Act, the provisions that apply to banks.[3] Section 16, 12 U.S.C. § 24 Seventh, provides in relevant part:

> The business of dealing in securities and stock by the [national bank] shall be limited to purchasing and selling such securities and stock without recourse, solely upon the order, and for the account of, customers, and in no case for its own account, and the association shall not underwrite any issue of securities or stock.

Section 5(c) of the Glass-Steagall Act, 12 U.S.C. § 335, provides that State member banks are subject to the limitations of

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2 According to Bankers Trust's submission, virtually all of the institutions that purchase paper placed by Bankers Trust qualify as "accredited investors" as defined in the regulations of the Securities and Exchange Commission governing the limited offer and sales of securities without registration under the Securities Act. *See* 17 C.F.R. § 230.501(a).

3 The other two provisions of the Glass-Steagall Act, sections 20 and 32, apply to bank affiliates. Section 20 of the Act, 12 U.S.C. § 377, prohibits affiliates of member banks from being "engaged principally in the issue, flotation, underwriting, public sale, or distribution" of securities. In addition, section 32 of the Act, 12 U.S.C. § 78, prohibits member banks from having director, officer or employee interlocks with companies "primarily engaged" in the securities business.

section 16 with respect to dealing and underwriting in securities.[4]

Section 21(a)(1) of the Glass-Steagall Act, 12 U.S.C. § 378 (a)(1), provides that it is unlawful —

> For any person, . . . or . . . organization, engaged in the business of issuing, underwriting, selling, or distributing, at wholesale or retail, or through syndicate participation, stocks, bonds, debentures, notes, or other securities, to engage at the same time . . . in the business of receiving deposits.

In its opinion in this case, the Supreme Court made clear that Bankers Trust's activities are subject to both sections 16 and 21. *Bankers Trust*, 104 S. Ct. at 2986.

The applicability of sections 16 and 21 to bank services for issuers of securities was addressed in the Board staff's 1977 survey of bank-assisted private placement activities.[5] In assisting the private placements of securities, banks generally advise the issuer of the securities regarding the terms and timing of the transaction, solicit a limited number of institutional investors potentially interested in purchasing the securities, and often assist in negotiations between the issuer and purchasers. The staff concluded that the commercial bank private placement activities it examined would not violate the Glass-Steagall Act.

With respect to section 16, the staff stated that in assisting private placements of securities, a bank does not act for the account of the bank but rather "for the account of customers," within the express authorization of section 16. In the staff's

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4 Section 16 creates several exceptions to the general prohibition against underwriting and dealing in securities. For example, section 16 provides that a national bank (and consequently a state member bank) may underwrite and deal in obligations of the United States, general obligations of states or political subdivisions of states, and obligations of or guaranteed by certain government agencies.

5 Federal Reserve Board Staff, Commercial Bank Private Placement Activities (1977) ("Private Placement Study").

opinion, the issuer, which may or may not have a preexisting relationship with the bank, was a "customer" of the bank's private placement services for purposes of section 16.

With respect to section 21, the staff, citing analogous provisions in the federal securities laws, concluded that commercial bank private placement assistance does not constitute "distributing" or "underwriting," since no "public offering" of securities was involved. Finally, the staff concluded that a bank's activities would not constitute "selling" for purposes of section 21 since the activities fall within the provisions of section 16 permitting banks to "sell" securities for the account of customers.

The staff's legal conclusions were cited with approval in a joint study of bank private placements conducted by the three federal bank regulatory agencies in 1978.[6]

III. *Discussion*

A. *Bankers Trust's Activities as "Selling" Commercial Paper*

Section 16 of the Act provides that the "business of dealing in securities" by a national (and thus a state member) bank "shall be limited to purchasing and selling such securities and stock without recourse, solely upon the order, and for the account of, customers, and in no case for [the bank's] own account." It is established that this provision authorizes banks to buy and sell securities as the agent for bank customers, provided that (1) the bank acts solely as agent and not for its own account, (2) the securities are bought or sold without recourse to the bank and (3) the bank acts solely on the order and for the account of a customer.[7]

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6 Comptroller of the Currency, Federal Deposit Insurance Corporation, Federal Reserve Board, Commercial Bank Private Placement Activities 12 (1978) ("Joint Private Placement Study").

7 *See Securities Industry Association* v. *Board of Governors (Schwab)*, 104 S. Ct. 3003, 3011 n.20 (1984) ("*Schwab*"); *Securities Industry Association* v. *Comptroller of the Currency*, 577 F. Supp. 252, 255 (D.D.C. 1983), *aff'd per curiam*, Nos. 84-5026, 84-5085 (D.C. Cir. April 12, 1985).

Section 21 provides that depository institutions may not engage in the business of "selling" securities. Since section 16 of the Act authorizes banks to engage to some extent in selling securities, however, section 21 should not be interpreted as prohibiting the kinds of selling activities authorized by section 16.[8] In *Bankers Trust*, the Supreme Court recognized that "§ 16 and § 21 seek to draw the same line." 104 S. Ct. at 2986.

In the Board's view, Bankers Trust's placement of commercial paper as described in this ruling falls within the scope of activities authorized by the terms of section 16. Bankers Trust's activities consist essentially of soliciting as agent of a commercial paper issuer various prospective institutional purchasers of the paper and providing the purchasers with financial information concerning the issuer.[9] In conducting these functions, the bank is "selling" commercial paper within the literal definition of that term.[10] These selling activities are authorized by the terms of section 16 because, first, the bank does not purchase for its own account the commercial paper it places or extend credit to the issuer of the commercial paper in a manner that is functionally equivalent to purchasing the paper; second, Bankers Trust does not enter into any arrangement under which it guarantees or assumes any market risk regarding the paper it places; and third, the bank places commercial paper solely on the order of the bank's customer, the commercial paper issuer.

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8 The SIA argues that when the Act was adopted, "selling" was understood to encompass the activities of persons who promoted securities and received a commission for their services. The Board agrees that, viewed in isolation, the term "selling" might literally include such activities. However, the terms as used in section 21 must be viewed in the context of the provisions of section 16, since it is commonly understood that the prohibitions in sections 16 and 21 are "coextensive." *Banker Trust*, 104 S. Ct. at 2986.

9 Bankers Trust also advises the issuer regarding the rates and maturities of a proposed issue. This activity has not been challenged and is not at issue in this proceeding.

10 *E.g.*, *Webster's New International Dictionary* 2272 (2d. ed. 1959).

As Agent, Not as Principal. Bankers Trust states that neither the bank nor any of its affiliates purchases or repurchases commercial paper placed by the bank. Bankers Trust obtains no ownership or security interest in the instruments it places and does not take these obligations as collateral for any loans made by the bank. The bank no longer makes loans to commercial paper issuers, at or near the commercial paper rate, to cover any unsold portion of a commercial paper issue. In its December 1984 statement on this matter, the Board found that this practice appeared to be the economic equivalent of the bank's purchase with its own funds of some of the unsold commercial paper, which would appear to constitute the "selling" or "underwriting" of commercial paper securities for Glass-Steagall Act purposes.

The SIA and Goldman Sachs argue that nevertheless Bankers Trust continues to invest its funds in the commercial paper it places because the bank extends lines of credit to some of the commercial paper issuers.[11]

According to Bankers Trust's submission, however, if the bank provides a line of credit to a commercial paper issuer, it does so as part of its ordinary commercial lending functions. The bank states that the decision to grant the line of credit is a separate and independent one that is in no way related to the commercial paper placement service.

The Board believes that these current lending practices differ substantially from the bank's now-discontinued practice of extending commercial paper-related loans to issuers, which the Board found was likely to involve the bank as a principal in the placement function. The commercial paper-related loans were a special service made available by the bank to issuers ostensibly to bolster the efficiency of the placement service. Under this practice, the bank's decision to extend credit to the issuer was

11 It is clear that term loans made by the bank to the commercial paper issuer or credit extended to the issuer for a specific purpose as a part of the bank's ordinary commercial lending functions cannot reasonably be viewed as tantamount to the bank's purchase of unsold commercial paper for its own account.

made at the end of the selling day when the degree of success of the bank's placement efforts became known. As the Board has recognized, extensions of credit under such circumstances might be interpreted as in substance the bank's purchase of the unsold commercial paper for resale.

In the Board's view, these factors are not present if Bankers Trust extends lines of credit to issuers in such a manner that drawings under the lines of credit are not related in time or purpose so as to support the issuer's commercial paper activities. In describing its activities, the bank has stated that the granting of credit is unrelated to the placement of commercial paper and the timing of the bank's decision to extend a line of credit to a commercial paper issuer is independent of the timing of the bank's efforts to place the issuer's commercial paper. Accordingly, the Board assumes that if the bank advances funds to the issuer under the line of credit it would do so under different terms, at different times, and for different purposes than if the bank had purchased unsold commercial paper for resale. To this end it would be reasonable to expect the bank to keep appropriate records to demonstrate adequately that loans were in fact granted independently of the bank's role as commercial paper placement advisor to a borrower/issuer and not for the purpose of backing an issue. It would be clear that the lines would not be for those purposes if there were documentary evidence of, for example, substantial participation in the loan by other lenders, or a documented special purpose loan, such as for financing of equipment purchases, plant expansion, or inventories and receivables, that differed substantially in terms of timing, maturity and interest rate from the commercial paper placed or outstanding. Moreover, as a general matter, in order to ensure that this separation is maintained in practice and that funds borrowed from the bank are not used to support commercial paper that the bank has sold as agent, it would be appropriate and necessary for the bank to assure itself that any funds advanced to a commercial paper issuer under any line of credit are not used to repay

any commercial paper of the issuer placed by the bank or to cover an unsold portion of a commercial paper issue placed by the bank. Under the previously outlined framework with respect to extensions of credit to issuers, the Board finds that the bank would be acting as agent, not principal in conducting its commercial paper activities.

Without Recourse. The requirement in section 16 that a bank's selling of securities be "without recourse" has been viewed as prohibiting the bank from assuming the liability of a maker or endorser of the securities or from entering into any other arrangement under which the bank assumes the risk of change in the value of the underlying securities.[12] Bankers Trust states that it does not endorse or guarantee the commercial paper it places and does not enter into any similar arrangement.[13] Nor is there any evidence in its description of its activities that the bank assumes any risk of fluctuation in the market value of the commercial paper it places.

Goldman Sachs and the SIA allege that Bankers Trust does not place commercial paper "without recourse" because in conducting the activity the bank may be subject to potential liability under the antifraud provisions of the securities laws. While it is possible that Bankers Trust might be liable for monetary damages to commercial paper purchasers under the securities laws if the bank were to make a false or misleading misrepresentation or material omission (*see* 15 U.S.C. § 771(2)), liability premised primarily on such misconduct by the bank does not appear to be the contractual type of

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12 *BankAmerica Corp./The Charles Schwab Corp.*, 69 Federal Reserve Bulletin 105, 115 (1983), *aff'd sub nom. Securities Industry Ass'n* v. *Board of Governors (Schwab)*, 104 S. Ct. 3003 (1984) ("Schwab"); *Awotin* v. *Atlas Exchange Nat'l Bank*, 295 U.S. 209, 212 (1935).

13 The Board's analysis is premised on the assumption that Bankers Trust does not provide its letter of credit to support a particular issue of commercial paper placed by the bank, as is sometimes the practice in the commercial paper market.

obligation the "without recourse" provision in section 16 was designed to prohibit. It has been held that the "without recourse" provision in section 16 does not preclude a bank from engaging in an otherwise lawful securities transaction merely because the bank might incur some liability in connection with the transaction.[14]

On the Order of Customers. None of the commenters contested Bankers Trust's statement that it places commercial paper only at the direction of the issuer. According to Bankers Trust's submission, the issuer, not the bank, decides whether to raise funds by issuing commercial paper and, if so, in what amount. The commercial paper issuer is clearly a "customer" of the bank, under the usual and ordinary meaning of that term.

The Board further believes that section 16 does not require that the issuer/customer whose commercial paper is placed by Bankers Trust be a customer of some other service offered by the bank. Nothing in the literal terms of section 16 requires a preexisting customer relationship as a prerequisite to permissible agency sales and purchases of securities. In addition, in delineating the scope of the activities permitted by section 16, both the courts and the administrative agencies have rejected any requirement of a preexisting customer relationship.[15] As

14 *Securities Industry Ass'n* v. *Board of Governors*, 716 F.2d 92, 100 n.4 (2d Cir. 1983), *aff'd*, 104 S. Ct. 3003 (1984). The securities industry representatives assert that the potential liability of the bank under the securities laws is significant, noting that in the rare case of a default by a commercial paper issuer, the courts have applied strict standards of liability on the dealers involved. However, the Board is of the view that the fact that a particular bank may not comply in a given case with all applicable legal requirements does not mean that the activity itself is an unlawful one. Banks may be subject to liability under the securities laws in conducting many traditional banking operations. *See, e.g., Radzanower* v. *Touche Ross & Co.*, 426 U.S. 148, 150 (1976).

15 *Securities Industry Ass'n* v. *Comptroller of the Currency*, 577 F. Supp. at 254-55; *New York Stock Exchange, Inc.* v. *Smith*, 404 F. Supp. 1091, 1097-1100 (D.D.C. 1975), *vacated for lack of ripeness*, 562 F.2d 736 (D.C. Cir. 1977), *cert. denied*, 435 U.S. 942 (1978); Private Placement Study, at 95-99.

the Private Placement Study expressly found, since securities sales by banks as agent of an issuer/customer are fully consistent with the terms and purposes of the Glass-Steagall Act, there is no reason to distinguish between existing and new customers. Private Placement Study, at 98-99.

The Board notes that the positions taken in the Private Placement Study have been expressly concurred in by OCC and the FDIC[16] and relied on by banks for a number of years without judicial challenge.[17] In addition, the agencies' private placement studies were undertaken in response to express congressional requests,[18] and Congress has not acted to modify or overturn the conclusions reached by the agencies.[19]

In sum, Bankers Trust's placement of commercial paper, as described, complies with the literal terms of section 16, because Bankers Trust acts solely as agent and not for its own account, the paper is placed without recourse against the bank, and the bank places commercial paper solely at the request and on the order of its customer, the commercial paper issuer.

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16 Joint Private Placement Study, at 3.

17 The SIA and Goldman Sachs cite administrative interpretations issued by the Board and the Comptroller prior to the private placement studies. The rationale of the Board's ruling in *First Arabian Corporation*, 63 Federal Reserve Bulletin 66 (1977), and the letters of the Deputy Comptroller of the Currency in 1974 and 1975 was expressly rejected by the later, more comprehensive analysis in the Private Placement Study.

18 *See* Joint Private Placement Study, app. A.

19 In its comment, Goldman Sachs notes that section 16 also provides that a bank's purchase of securities must be on the order of customers and argues that if a commercial paper purchaser solicited by the bank also happens to be a bank customer, the purchase of the paper would not be "solely on the order" of the customer/purchaser. However, the requirement that purchases of securities be on the order of customers is a limitation on purchases made by the bank and, as explained above, Bankers Trust does not itself purchase the commercial paper it places, and the decision to purchase the paper appears to be made by the purchaser alone. The bank purchases commercial paper where the purchase is directed by a bank customer. If conducted as described, these purchases comply with section 16.

Legislative History and Purposes of the Act. The conclusion that Bankers Trust's commercial paper placement falls within the authorization in section 16 is consistent with the legislative history and purposes of the Glass-Steagall Act. The types of practices that motivated passage of the Act were described in detail in the legislative history. The placement of securities with a limited number of purchasers by a bank, acting solely as agent of an issuer, was not identified as a source of congressional concern.[20]

The Board's conclusion is also in accord with the basic objectives of the Act, because under the framework for the conduct of these activities outlined in this ruling, a bank may only act as an agent and may not commit its own funds in connection with the transaction involved. Thus, bank funds would not be lost in speculative investments nor would the bank be subject to the more subtle hazards of investment banking, which arise when a bank deals in securities for its own account. As the Supreme Court has made clear, it was mainly these dangers that were the basis of congressional concern over the securities activities of banks. *Schwab*, 104 S. Ct. at 3011.

The SIA claims that the legislative history shows that the exception in section 16 for agency activities was intended only to allow banks to assist customers in secondary market trading, *i.e.*, securities brokerage. However, the placement of commercial paper or other securities solely as the agent of the issuer is authorized by the literal language of in [sic] section 16. In addition, as explained above, no significant evidence has

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20 *See generally* S. Rep. No. 77, 73d Cong., 1st Sess. (1933); *Operation of the National and Federal Reserve Banking Systems: Hearings on S. Res. 71 Before a Subcomm. of the Senate Comm. on Banking and Currency*, 71st Cong., 3d. Sess. 1052-68 (1931). The previous interpretations of section 16 by the OCC and the Board cited by the SIA have now been rejected as unnecessarily overcautious and contrary to legislative intent, and the rejection of the early rulings has been upheld as a reasonable exercise of agency discretion. *Securities Industry Ass'n* v. *Comptroller of the Currency*, 577 F. Supp. at 255.

been cited by the SIA or has been found indicating that secondary market brokerage activities were the *only* functions intended to be authorized or that the statutory terms should not be read literally.

The SIA further contends that any interpretation of section 16 that permits banks to act on behalf of issuers in the initial dissemination of new issues of securities to the public would frustrate a principal objective of the Act, *i.e.*, to bar banks from the investment banking business. However, a ruling that the issuer of securities is a "customer" for purposes of section 16 does not grant commercial banks entry into the investment banking field. Section 16 permits sales as agent only, and investment banking firms, as explained below, act both as principal and as agent in underwriting and dealing in securities. Moreover, the authorization in section 16 for agency sales of securities by banks is circumscribed by other applicable prohibitions in the Act, in particular the prohibitions in sections 16 and 21 against underwriting and distributing securities. As discussed below, these prohibitions limit a bank's activities as an agent for the issuer of securities to the extent the activities can be characterized as the underwriting or distribution of securities.

Similarly, the fact that banks did not, until recently, act for issuers in the placement of commercial paper (*see Bankers Trust*, 104 S. Ct. at 2992) is not, in the Board's opinion, significant. The recent significant growth of the commercial paper market as a replacement for bank loans in meeting short-term funding needs has put new pressures on banks to seek supplemental income and to preserve existing customer relationships.[21] Forbearance from a particular activity because, for example, of a lack of an economic incentive to provide it, should not be viewed in itself as persuasive evidence that the activity is unlawful.

21 *See, e.g.*, M. Stigum, *The Money Market* 626-28 (1983).

B. *Banker Trust's Activities as "Underwriting" or "Distributing" Commercial Paper*

Section 16 provides that a national bank (and therefore a state member bank) "shall not underwrite any issue of securities or stock." Section 21 provides that depository institutions may not engage in the business of "underwriting" or "distributing" securities.[22]

After carefully reviewing Bankers Trust's description of its placement operations, the Board is of the view that these activities do not contravene the Act's ban on underwriting or distributing securities. The terms "underwriting" and "distributing," as described by the Supreme Court in the *Schwab* decision and as defined in the Securities Act of 1933, typically refer to the process by which securities are offered to the public. Bankers Trust states that it does not offer commercial paper to the public or through any general solicitation or advertisement, but places the paper by individually contacting institutional investors. The bank further states that it places only commercial paper that is exempt from the registration requirements of the Securities Act pursuant to section 3(a)(3) of that Act. This exemption applies only to paper that is not ordinarily purchased by the general public.

Scope of "Underwriting" and "Distributing." In its opinion in *Schwab*, the Supreme Court discussed the meaning of the terms "underwriting" and "distributing" as used in the Glass-Steagall Act. In *Schwab*, the Supreme Court held that the activities of a securities broker—purchasing and selling securities in the secondary market on the order of customers—do not constitute the "public sale" of securities for purposes of section

22 Sections 16 and 21 also prohibit a depository institution from engaging in the business of issuing or dealing in securities. No allegation has been made that Bankers Trust's commercial paper activities constitute the issuance of securities. As noted above, the Board does not believe that the bank's activities as described in this Statement would place it in the role of a dealer, *i.e.*, buying and selling commercial paper for its own account.

20 of the Act, which governs affiliations between member banks and securities firms. The Court found that the term "public sale" is used in section 20 in conjunction with other terms, including "underwriting" and "distribution," and that these terms traditionally apply to a function distinctly different than that of a securities broker. 104 S. Ct. at 3010.

Specifically, the Court noted that "[a]n underwriter normally acts as principal whereas a broker executes orders for the purchase or sale of securities solely as agent." *Id.* "In the typical distribution of securities," the Court added, "an underwriter purchases securities from an issuer . . . [and] distribut[es] these securities to the public," often acting with other underwriters and dealers. *Id.* n.17. The Court further observed that "[u]nderwriters also may distribute securities under a 'best efforts' agreement pursuant to which large blocks of specific issues of securities are offered to the public by the investment banker as agent for the issuer." *Id.*[23] A key element that emerges from the Court's description of the role of an underwriter in the distribution of securities is that the process involves the offering of securities to the public.[24]

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23 The Court further stated that a "best efforts" distribution is not technically an underwriting as that term has been defined traditionally, but did not reach the question whether a "best efforts" distribution, unlike "firm commitment" underwriting, constitutes "underwriting" for purposes of the Glass-Steagall Act, because the brokerage activity at issue there did not involve any such distribution plan. *Id.* It is well-settled, however, that under the federal securities laws a best efforts distribution is "underwriting." *See Dale* v. *Rosenfeld*, 229 F.2d 855 (2d Cir. 1956).

24 *See* 1 L. Loss, *Securities Regulation* 164 (2d ed. 1961) (in typical "firm commitment" underwriting, the issuer sells securities outright to principal underwriters, which in turn sell at a price differential to a larger group of dealers, which sell at another differential to the public); *see also* F. Burtchett, *Corporation Finance* 407, 428 (1934) ("underwriting" involves an agreement "to buy such portion of an issue of securities as cannot be sold to the public . . . stand[ing] ready to purchase in case the public does not" and "distribution" is the process by which corporations sell securities in the "public investment markets").

These interpretations of the terms "underwriting" and "distributing" in the Glass-Steagall Act are consistent with the construction of analogous terms used in the Securities Act of 1933. Under section 2(11) of the Securities Act, the term "underwriter" is defined as a person who purchases from an issuer with a view to distribution, or who offers or sells for an issuer in connection with a distribution. 15 U.S.C. § 77b(11). As traditionally interpreted, the term "distribution" has been viewed for purposes of this definition as substantially synonymous with a public offering of securities.[25] In addition, section 4(2) of the Securities Act (15 U.S.C. § 77d(2)) exempts from the registration and prospectus delivery requirements of the Act those transactions that do not involve a public offering.

The SIA argues, however, that reliance on the provisions of the Securities Act is not appropriate in construing the Glass-Steagall Act, especially in light of the differing objectives of the two statutes. The Board agrees that the interpretation of terms in the Securities Act should not be considered controlling for purposes of the Glass-Steagall Act. The Glass-Steagall Act and the federal securities laws were intended to accomplish somewhat different objectives.[26] Moreover, the courts have recognized that a mechanical approach that treats the interpretations of the securities laws as determinative for Glass-

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25 H.R. Rep. No. 1838, 73d Cong., 2d Sess. 41 (1934) ("The Commission has recognized by its interpretations that a public offering is necessary for a distribution. Therefore there can be no underwriter within the meaning of the act in the absence of a public offer. . . ."); Private Placement Study, at 89; 1 L. Loss, *supra*, at 551. These authorities cast doubt on the SIA's contention that anyone who sells securities for an issuer is an underwriter under the Securities Act, without consideration of whether there is a public offering of securities.

26 *Compare Board of Governors* v. *Investment Company Institute*, 450 U.S. 46, 61 (1981) ("[T]he Glass-Steagall Act was enacted in 1933 to protect bank *depositors* from any repetition of the widespread bank closings that occurred during the Great Depression" (emphasis added) *with United Housing Foundation, Inc.* v. *Forman*, 421 U.S. 837, 849 (1975) (The securities legislation of 1933 and 1934 was enacted "to prevent fraud and to protect the interests of *investors*") (emphasis added).

Steagall Act purposes in all cases would produce results that clearly are at odds with the objectives of that Act.[27]

However, the reasoning and analysis of the Supreme Court's opinion in *Bankers Trust* suggest that it is appropriate to rely on the securities laws interpretations as providing at least some guidance regarding the meaning of similar terms in the Glass-Steagall Act.[28] In deciding in *Bankers Trust* that the commercial paper placed by the bank constitutes "notes, or other securities" for Glass-Steagall Act purposes, the Supreme Court found "considerable evidence" that the term "notes" in that Act covered commercial paper in the fact that the Securities Act definition of "security," enacted contemporaneously with the Glass-Steagall Act by the same legislators, explicitly covered commercial paper. 104 S. Ct. at 2987. In addition, this approach is in accord with the 1977 Private Placement Study, which found the Securities Act definitions "a compelling analogy" for the meaning of the terms "underwriting" and "distributing" in the Glass-Steagall Act (at 89).

The SIA also argues that reliance on the Securities Act is not appropriate here because nonpublic offerings are excluded from that Act's registration requirements by express exception, and the provisions of sections 16 and 21 of the Glass-Steagall Act contain no similar exception. However, the notion that an underwriter sells securities for an issuer in connection with a distribution of securities appears to be an integral part of the

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27 *Investment Company Institute* v. *Conover*, 596 F. Supp. 1496 (D.D.C. 1984), *appeal docketed*, (D.C. Cir.); and *Investment Company Institute* v. *Conover*, 593 F. Supp. 846 (N.D. Cal. 1984), *appeal docketed*, (9th Cir.) (interests in traditional commingled trust funds created by banks, although "securities" under the Securities Act, are not "securities" for purposes of the Glass-Steagall Act).

28 The comments of the OCC support this conclusion, noting that interpretations under the Securities Act serve as a persuasive source of authority on the accepted usage of terms used in both that Act and the Glass-Steagall Act, but that the Securities Act interpretations should not be controlling for Glass-Steagall purposes, in view of the different purposes of the two statutes and the obligation of the banking agencies to bring their expertise to bear in interpreting the Glass-Steagall Act.

Securities Act's definition of "underwriter." As a leading authority on the Securities Act has recognized, even an investment banker is not a statutory underwriter in arranging a private placement on behalf of an issuer.[29] Thus, the Board finds the construction of the terms "underwriter" and "distribution" as used in the Securities Act to cover activities involving a public offering of securities affords some probative (but not controlling) evidence as to the kinds of securities marketing activities Congress meant to forbid to banks by enacting Glass-Steagall.

The SIA further contends that nonpublic, limited offerings of securities to sophisticated purchasers should not be excluded from the Act's prohibition against "underwriting," on the basis of the Supreme Court's statement in *Bankers Trust* that the Glass-Steagall Act's prohibition on underwriting "admits of no exception according to the particular investment expertise of the customer" (104 S. Ct. at 2991). It is not reasonable to assume, however, that the Supreme Court in *Bankers Trust* concluded that all securities placement activities involving a limited number of sophisticated purchasers are inconsistent with the Act. If so, it would have been unnecessary for the Court to remand the case for a ruling on the "underwriting" issue. Similarly, in *Schwab* the Court left open the possibility that bank participation even in a "best efforts" underwriting of securities might not violate the Glass-Steagall Act.

In sum, the Board believes that a bank's activities that do not involve an offering of securities to the public do not constitute the "underwriting" or "distributing" of securities under the Glass Steagall-Act.[30]

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29 1 L. Loss, *supra*, at 547.

30 It is also contended that this interpretation represents an attempt to employ administrative criteria to curtail operation of the statutory language, the sort of "regulatory approach" to the Glass-Steagall Act rejected in *Bankers Trust*. *See* 104 S. Ct. at 2988. However, the interpretation adopted by the Board here represents a determination that neither the language nor the purposes of the Act's prohibitions encompass activity involving only the nonpublic offering of securities. In contrast, in *Bankers Trust*, it was

Bankers Trust's Activities as Involving a Public Offering. After reviewing the method of placing commercial paper described by Bankers Trust in light of the criteria described above, the Board believes that these activities do not constitute the "underwriting" or "distributing" of securities for purposes of the Glass-Steagall Act. On the basis of the facts described, Bankers Trust does not engage in a public offering of commercial paper in the ordinary sense of the term.

In reaching the conclusion that Bankers Trust makes no public offering of commercial paper, the Board has considered the marketing and solicitation practices followed in transactions assisted by Bankers Trust, the nature of the security placed, the type of investors with whom Bankers Trust would negotiate on behalf of issuers for the purchase of commercial paper, and the number of investors with whom the bank would deal in assisting a private placement. According to its submission to the Board, Bankers Trust places commercial paper by separately contacting large financial and non-financial institutions. The bank states that it does not place commercial paper with any individuals. The bank further represents that the maximum number of offerees and purchasers of commercial paper placed by the bank in any given case is relatively limited and that it makes no general solicitation or advertisement to the public with respect to commercial paper its places.[31]

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conceded that the statutory term "notes" literally covered commercial paper, and the Court rejected administrative attempts to confine the reach of the term to notes that are investments. 104 S. Ct. at 2987-88.

31 With respect to whether Bankers Trust's activities constitute general advertising and solicitation as that term is used under the Securities Act, interpretations of the term "general solicitation" have often focused on the presence of a prior relationship between the issuer and the offerees. Bankers Trust does not necessarily have such a prior business relationship with offerees. In addition, Bankers Trust publicizes its status as agent-adviser for commercial paper issues in business publications, such as the *Wall Street Journal*. Nevertheless, the bank's published statements may not be considered offers under federal securities laws, since they do not promote the securities of a particular issuer but merely advertise the business activities of the Bank.

Moreover, the commercial paper placed with the bank's assistance is issued in very large average minimum denominations, which are not a likely investment of the general public.[32] Finally, the Board also considers significant Bankers Trust's representation that it places only commercial paper that qualifies for an exemption from registration under section 3(a)(3) of the Securities Act (15 U.S.C. § 77c(a)(3)), which applies only to obligations "of a type not ordinarily purchased by the general public."[33]

The comments of the securities firms express the view that Bankers Trust should be deemed to be making a public offer of commercial paper, because the bank's placement procedures do not fully comply with each of the procedural requirements of the SEC's Regulation D. In Rule 506 of Regulation D, the Commission has specified certain types of transactions that are deemed not to involve a public offering of securities within the meaning of section 4(2) of the Securities Act.

Bankers Trust appears to be in compliance with the major substantive provisions of Regulation D. It offers commercial paper only to a limited number of institutions, which meet the definition of "accredited investor" in Regulation D (or are inherently financially sophisticated, such as foreign central banks).[34] In addition, according to the bank, its commercial

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32 Goldman Sachs points out that the functions of a nonbank commercial paper dealer have been characterized by the courts as "underwriting." However, it appears that these judicial characterizations were premised on the facts that a dealer "[took] the unsold portions [of the paper] into its inventory" (*University Hill Foundation* v. *Goldman Sachs & Co.*, 422 F. Supp. 879, 900-01 (S.D.N.Y. 1976)), or that the paper had been "obviously offered and sold to the general public" (*Sanders* v. *John Nuveen & Co.*, 463 F.2d 1075, 1079 (7th Cir.), *cert. denied*, 409 U.S. 1009 (1972)). The Board's ruling in this case is premised on the fact that the bank performs neither of these functions.

33 SEC Securities Act Release No. 4412 (September 20, 1961). Thus, the bank would not distribute prospectuses or similar material concerning the commercial paper placed by the bank.

34 Under Regulation D, securities sold to "accredited investors" (and up to 35 non-accredited investors) may not be considered a "public offering,"

paper placement activities do not include any form of general solicitation or general advertising to the public, which is also consistent with the Regulation.[35] The provisions of Regulation D with which Bankers Trust's activities do not comply, relating to notice to the SEC and restrictions on resale by the purchaser, do not appear to be germane to the core concerns of the Glass-Steagall Act.

The Board does not believe, however, that the bank's complete compliance with Regulation D should be determinative of whether a public offering is involved for Glass-Steagall Act purposes. Even for purposes of the securities law, Regulation D provides only a "safe harbor" for certain types of offerings involving facts and circumstances that the SEC has reviewed and determined do not constitute public offerings. Regulation D is not intended to define the outer limits of a "nonpublic offering" for purposes of section 4(2). The Supreme Court has held that whether a public offering exists depends to a large extent on the facts and circumstances of each particular offering. *See SEC* v. *Ralston Purina Co.*, 346 U.S. 119 (1953).

Goldman Sachs also argues that Bankers Trust is engaged in a "distribution" of commercial paper because, given relatively short-term maturity of the paper, Bankers Trust is engaged in placing securities on a relatively frequent basis. However, the Board does not believe that the frequent nature of the activity alone would necessarily convert what is in fact a private offering into a public one. Nevertheless, if the bank's activities become directed toward marketing securities to an ever-broadening class of customers, the character of the offering eventually could change from nonpublic to public and the provisions

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even if a large number of accredited investors of securities are involved. Accredited investors, which by definition include banks, insurance companies, investment companies and similar institutions, are presumed not to need the protection provided by registration. It should be noted that under the Securities Act substantial compliance with Regulation D is insufficient. In order to obtain the protection of the "safe harbor" provided by Regulation D, all its conditions must be met.

35 *See* n.31, *supra*.

of the Act could then apply. There is no indication in the record, however, that Bankers Trust intends to expand the modified activities it now engages in.[36]

C. *Bankers Trust's Activities in Light of the Hazards the Act Was Intended to Prevent*

In judging a particular activity of banking organizations against the standards of the Glass-Steagall Act, the Supreme Court has examined that activity in light of the "hazards" and "financial dangers" Congress intended the Act to prevent.[37] Of concern to Congress was "the obvious danger" that, as a result of securities activities, bank assets would be invested in speculative or illiquid securities. Importantly, however, the Act was also meant to forestall "the more subtle hazards" that result from the promotional pressures inherent in investment banking. Of crucial concern to Congress was the fear that a bank's involvement in investment banking might "impair its ability to function as an impartial source of credit," because the bank might be tempted to make unwarranted loans to companies whose securities the bank was promoting, or to shore up a foundering affiliated securities company, or to facilitate the purchase of securities marketed by the bank. It was also feared that the promotional interest of an investment banker would conflict with the commercial banker's obligation to provide disinterested investment advice to trust department customers as well as to corporate customers seeking guidance regarding the best method of raising funds. In addition, Congress also believed that if customers suffered losses on investments promoted by the bank, public confidence in the bank and cus-

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36 Because Bankers Trust's current placement methods do not involve a public offering, and thus are not "underwriting" for purposes of the Glass-Steagall Act, it does not appear necessary to determine in this case whether a bank's participation in a public offering of securities as the agent of the issuer, *i.e.*, "best efforts" underwriting, is covered by the Act's prohibitions.

37 *Investment Company Institute* v. *Camp*, 401 U.S. 617, 630-34 (1971); *Board of Governors* v. *Investment Company Institute*, 450 U.S. at 66-67; *Bankers Trust*, 104 S. Ct. at 2984-86; *Schwab*, 104 S. Ct. at 3011.

tomer good will would be damaged. Finally, Congress also recognized that a bank might be tempted to market securities of a company in financial difficulty so that the company could repay a loan from the bank.

However, the Board believes that Bankers Trust's placement of commercial paper, as described in this Statement, are not likely to raise the concerns identified by the courts as the evils at which the Glass-Steagall Act was aimed.

The Supreme Court's Opinion in Bankers Trust. The Board recognizes that certain statements in the Supreme Court's opinion in *Bankers Trust* note that the Bankers Trust's commercial paper activities would implicate some of the concerns that prompted enactment of the Glass-Steagall Act. In particular, the Court stated that the bank's "pecuniary stake" in the success of commercial paper sales was "fundamentally incompatible" with the bank's role as "disinterested lender and advisor." 104 S. Ct. at 2989.

Although these statements were made in the course of reviewing the Board's ruling that commercial paper is not a security under the Act, they must be given careful consideration here. Nevertheless, the Board does not believe that the *Bankers Trust* decision requires a finding the Bankers Trust's placement activities will produce the dangers the Act was designed to prevent. The Board's ruling before the Supreme Court in *Bankers Trust* would have permitted a bank in placing commercial paper to purchase the paper for its own account and then resell it. Indeed, the Board subsequently found that there was a substantial likelihood that at the time of the Supreme Court's decision, Bankers Trust was in effect purchasing some commercial paper for its own account for resale. Thus, the bank's "pecuniary stake" in commercial paper placement was undoubtedly linked to the fact that the funds of the bank could be invested in the paper.

In the Board's judgment, the fact that Bankers Trust must conduct its commercial paper activities so that the bank will not directly or indirectly commit its own funds as a principal, represents a significant difference from the activities before the

Supreme Court in *Bankers Trust*. In its *Schwab* decision, the Supreme Court made clear that congressional concern about the securities activities of banks that resulted in the enactment of the Glass-Steagall Act was based on the fear that "bank funds would be lost in speculative investments" as well as on the existence of more "subtle hazards," all of which "are attributable to the promotional pressures that arise from . . . purchas[ing] and sell[ing] particular investments on [the bank's] own account." 104 S. Ct. at 3011 & n.23.

The Board finds that Bankers Trust's commercial paper placement does not involve the kind of pecuniary marketing incentive that is a hallmark of the investment banking business. The bank's interest in this activity is limited primarily to a contingent, agent/advisory fee for its commercial paper service, typically one-eighth of one percent or less of the total amount of the issuer's outstanding commercial paper, computed on an annualized basis. The bank's fee arrangement, which is usual in the highly competitive commercial paper market, appears to be relatively modest in comparison to fees received by investment bankers for typical investment banking services. Commercial paper activities are usually not a major profit center for nonbank commercial paper dealers, but instead are designed to encourage issuers to utilize the dealer's more lucrative underwriting services for bonds and equity securities.[38] Similarly, Bankers Trust represents that its commercial paper service is designed primarily to maintain the bank's relationship with its best commercial lending customers, which in the recent past have increasingly sought to satisfy their short-term funding needs in the commercial paper market, rather than through loans from the bank, which are more profitable for the bank. Thus, the bank no longer has the kind of "salesmen's stake" in its commercial paper placement operations that was present in its previous activity, and, as dis-

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38 *E.g.*, Lowenstein, *The Commercial Paper Market and the Federal Securities Laws*, 4 Corp. L. Rev. 128, 132 (1981). Accordingly, any significant change in the structure or operations of the recognized commercial paper market might change the Board's views expressed in this decision.

cussed above (page 13), the bank would not acquire such a stake through lending to issuers where the loans were unrelated to the commercial paper services. Accordingly, in the Board's judgment, it is not likely that the bank's interest in its commercial paper service would impair its objectivity as a source of credit or would cause the bank to jeopardize public confidence in the institution, to provide less than impartial advice, or to invest the bank's assets in speculative securities.

An underlying premise of the Glass-Steagall Act is the recognition that the high risks of investment banking are rewarded by high profitability and, driven by the search for large profits, banking institutions engaged in these activities would inevitably incur the conflicts of interest destructive of the public trust inherent in the banker's fiduciary responsibility for the proper handling and safeguarding of depositors' funds. This analysis does not apply to the proposal now under consideration by the Board, whereby the bank acts solely as agent in the placement of commercial paper. Under the previously outlined framework concerning the bank's conduct of these activities, the bank takes no risk with its own funds and, commensurate with this lack of risk, the rewards are small.

In addition, the bank supervisory agencies have had significant experience in reviewing the results of bank placement activities substantially the same as Bankers Trust's modified commercial paper operations. The Board, in its 1977 Private Placement Study, and the three banking agencies, in the 1978 Joint Study, exhaustively reviewed the activities of banks in privately placing long term debt and equity securities and found no empirical evidence that these activities resulted in harm to the bank or conflicts of interest. The Supreme Court did not have the benefit of this data before it in *Bankers Trust*. In light of these factors, the Board concludes that the concerns that motivated the adoption of the Glass-Steagall Act are not a likely result of Bankers Trust's commercial paper placement as described in this Statement.

Investment of Bank Funds. Bankers Trust's commercial paper placements will not result in the purchase or repurchase

by Bankers Trust of any commercial paper placed by the bank, or in the extension of credit that is equivalent to purchasing such commercial paper. Accordingly, it is unlikely that the bank's assets or depositors' funds could become tied up in illiquid or speculative commercial paper. As explained above in the Board's discussion of whether Bankers Trust acts for its own account in placing commercial paper, the Board believes that the bank's activities would be consistent with the Act only to the extent any credit extended by the bank to issuers does not represent the functional equivalent of purchasing unsold commercial paper. (See pp. 12-13).

Impartiality in Granting Credit. Several comments assert that, as a result of its commercial paper activities, Bankers Trust's ability to serve as an impartial provider of credit could be impaired, especially if the bank were induced to extend unsound loans to companies whose paper is placed by the bank in order to facilitate placement of the paper. The danger that the bank's objectivity in assessing credit risk might be damaged as a result of commercial paper operations is of particular concern to the Board. For example, it is likely that the personnel responsible for the bank's commercial lending operation will be aware, at least to some degree, of the bank's role in placing a borrower's commercial paper, especially given the bank's duty to maintain a thorough credit analysis of companies whose commercial paper is placed by the bank.

Nevertheless, the Board believes that, based on the particular circumstances involved here, the potential impairment of the bank's objectivity in assessing credit risk is not significant. In its submission to the Board, Bankers Trust states that it does not provide any letter of credit or enter into any other guarantee arrangement that would lend the bank's resources to increasing the acceptance of an issuer's commercial paper. Moreover, any credit lines extended to an issuer must be for a documented special purpose, or have substantial participation by other lenders, and have substantially different timing, terms, conditions and maturities from the commercial paper being placed. The Board's analysis here depends on the fact

that the bank will take adequate steps to assure its credit facilities are not utilized as a substitute for the purchasing of commercial paper by the bank.

Furthermore, because the potential financial gain to the bank from commercial paper placement activities is so small in relation to the principal amount of loans that would be extended by the bank, the Board does not believe that it is reasonable to assume that the bank would risk its own funds by making loans to issuers to shore up the issuer's financial condition or to make its obligations more acceptable to the market. Moreover, since, unlike the typical commercial paper dealer, Bankers Trust no longer acts as a principal in its commercial paper operations, the bank should not be tempted to use its credit facilities to assist in disposing of commercial paper inventory being carried by the bank.

Another factor supporting the Board's conclusion is the supervisory experience with bank-assisted private placements generally. The thorough review of bank practices in this area in the Private Placement Study detected no bank loans extended primarily because of bank involvement in private placements.[39] Private Placement Study, at 76.

Damage to Reputation and Good Will. Similarly, in the circumstances of this case the Board does not believe that confidence in the bank, in the eyes of depositors and the public, as well as in the eyes of bank customers that purchase commercial paper from the bank, would be damaged significantly if the issuers of the paper were to default. The Board believes that any such impact must be assessed in terms of the facts which would be readily available to the investing and depositing public. The bank would be acting solely as agent, not as a dealer or underwriter holding the defaulted paper in its

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39 Merrill Lynch points out that Bankers Trust might make loans to facilitate the purchase of commercial paper by the institutions to which it offers the paper. This danger, however, does not appear significant. The yields on commercial paper are generally lower than the rates charged by banks on loans. Therefore, using borrowed funds to purchase commercial paper would be unprofitable and unlikely.

portfolio. Any lending relationship with the issuer would be disclosed to the investor, and loans, if any, to the issuer would have to have been made on their own merits and not to support in any way the issuance, purchase or redemption of commercial paper. The Board also notes that, in placing the paper, the bank does not, and may not, offer commercial paper to the public, but only in the wholesale commercial paper market. Nor does the bank distribute prospectuses or other publicly disseminated material in connection with any specific commercial paper issue. In examining bank private placements generally, the Private Placement Study found no significant damage to a bank's reputation resulting from such activities. Private Placement Study, at 77.

Moreover, as Bankers Trust has described its operations, commercial paper is placed with only a limited number of institutions, only some of whom may be depositors of the bank. With regard to any given issue, therefore, it is likely that a very small fraction of depositors of the bank would hold paper placed by the bank. Even if these purchasers/depositors were to withdraw funds in the wake of a loss suffered on commercial paper perceived to be caused by the bank, the loss of business would not likely have an effect on the bank's safety or soundness. In addition, the institutions purchasing commercial paper from Bankers Trust generally meet the definition of "accredited investor" in the SEC's Regulation D,[40] and the bank provides no investment advice to the purchasers. Although the extent to which all commercial paper purchasers conduct their own independent credit analysis each time commercial paper is purchased is not clear, the financial expertise of the purchaser means that in the event of a default on commercial paper placed by the bank, the purchasers would, to some extent, be compelled to view the loss as at least partly the result of their own action or inaction. In these circumstances, investor or depositor loss of confidence in the bank simply because it acted as agent in the sale of commercial paper does not seem reasonable. The Board does not believe that Congress

40 *See* n.34, *supra*.

intended to prevent banks from engaging in otherwise permissible and riskless conduct on the basis of such remote and unreasonable behavior.

Use of Commercial Paper to Repay Bank Loans. The comments also point out the possibility that the bank may place commercial paper on behalf of an issuer that intends to use the proceeds to repay a loan from the bank to the issuer. The Board does not find this potential conflict of interest to be a likely result of Bankers Trust's modified activities. In addition, the financial condition of corporations that borrow in the commercial paper market is monitored by five independent rating services. Issuers with no rating or with a low rating, or whose rating has been downgraded, cannot easily place paper in the commercial paper market. Thus, it seems likely that an issuer experiencing financial problems would have difficulty placing commercial paper in the market, even if encouraged to do so by the bank. Moreover, the Board's conclusion that placement of commercial paper by Bankers Trust is permissible under the Act is based on the fact that the bank would not provide any letter of credit or other guarantee arrangement in an effort to make the paper more acceptable in the market.

As Bankers Trust notes, the antifraud provisions of the federal securities laws require the bank to disclose to the purchaser material facts concerning any lending relationship between the bank and the issuer and the use of the proceeds of the loan. Such disclosure would provide protection to the purchaser against any possible conflict of interest on the part of the bank. Thus, the Board's conclusion on the lack of conflicts of interest is premised on the assumption that, if the bank has a lending relationship with a particular issuer, the bank discloses to each purchaser with which the bank places the issuer's commercial paper at a minimum the existence of that relationship.

In addition, the regulatory agencies' empirical surveys of bank private placement activities found no evidence that this kind of conflict of interest occurs in practice. Although proceeds of securities privately placed by banks were occasionally

used to repay loans from the bank assisting the placement, no instance was found in which proceeds were used to pay a classified loan, *i.e.*, one that involved some risk of nonpayment to the bank.[41] The Board is not aware of any reason why experience in connection with the placement of commercial paper would be different.

Lack of Impartial Advice. Finally, the Board finds no realistic probability that Bankers Trust's modified commercial paper activities might interfere with the bank's duty to provide disinterested advice to its customers. Bankers Trust states that it does not purchase commercial paper for its trust department or any other accounts managed or advised by the bank or by any affiliate of the bank. The bank's practice in this area is in accord with the experience of the regulatory agencies with private placements generally.[42]

There is also the possibility that, because of the bank's desire to earn a fee for its commercial paper placement services, the bank might be less than objective in providing advice to corporate customers concerning the relative merits of various financing techniques. As explained above, the promotional incentive inherent in the commercial paper activity is not significant and is not likely to subject the bank to this kind of conflict of interest. The Board also notes that only a small number (about 1,200) of the nation's largest and financially strongest corporations are able to obtain the high ratings from the independent rating services that are a prerequisite to borrowing funds in the commercial paper market. Thus, even if Bankers Trust were to pressure its customers to use its commercial paper placement service, the customers would not be able to utilize the service unless they were financially strong

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41 Private Placement Study, at 70; Joint Private Placement Study, at 2. A loan is "classified" if it is determined that there is some risk of nonpayment or a well defined weakness in the asset.

42 Private Placement Study, at 79; Joint Private Placement Study, at 2. *See* 12 C.F.R. § 9.12(a).

enough to receive a high rating from the rating services.[43] The companies that are financially strong enough to obtain such ratings clearly have the resources and expertise to make their own judgments about the best methods for raising short-term funds. Bankers Trust states that the bank developed its commercial paper service because the bank's largest, most creditworthy borrowers independently decided to substitute commercial paper for traditional bank loans as the method of raising short-term funds.

D. *The Commercial Paper Guidelines*

In this proceeding, the SIA has requested the Board to withdraw its Commercial Paper Guidelines,[44] which were issued shortly after the Board's 1980 ruling on Bankers Trust's commercial paper activities. The Board issued the Guidelines on the premise that commercial paper was not a security for purposes of the Glass-Steagall Act.

Thus, it does not appear that the Guidelines are essential. If conducted within the limitations described in this Statement, the modified commercial paper services would constitute a lawful banking operation. The bank's compliance with principles of safety and soundness in conducting this activity could be assessed in the ordinary manner, *i.e.*, through the examination process, as is the case with all other banking functions.[45]

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43 Where it is clear from the structure of a particular proposal that in conducting a proposed activity a banking organization would not, because of inherent conflicts of interests, be able to provide impartial advice, the Board has refused to approve the proposal. *Security Pacific Corp.*, 71 Federal Reserve Bulletin 118 (1985). In this case the Board found that there were inherent conflicts of interest in bank holding company ownership of a bank and a company that acts as an impartial financial rating service.

44 Policy Statement Concerning Sale of Third Party Commercial Paper by State Member Banks, 46 Fed. Reg. 2933 (1981).

45 Goldman Sachs' reliance on the Board's decision in *Banco di Roma*, 58 Federal Reserve Bulletin 940 (1972), and similar decisions is misplaced. The activities involved in these prior rulings, unlike the placement activities here, were securities *underwriting* activities and clearly proscribed by the Act.

In many respects, the provisions in the Guidelines merely reiterated in the context of commercial placement activities, generally accepted principles of prudent banking. Accordingly, the Board believes that the Guidelines should be withdrawn.

IV. *Conclusion.*

After reviewing all of the relevant facts of record, the Board concludes that Bankers Trust's placement of commercial paper as described in this Statement does not constitute the "selling," "underwriting," or "distributing" of commercial paper securities for purposes of the Act. The Board finds that Bankers Trust's commercial paper operations are selling activities that are expressly authorized by the Act, since the bank places commercial paper only as an agent of the issuer, not directly or indirectly for its own account, and the paper is placed without recourse against the bank and solely on the order of its customer, the issuer of the paper. Moreover, in the Board's judgment, Bankers Trust does not underwrite or distribute commercial paper for purposes of the Act, because the bank does not engage in any widespread public promotion or solicitation of commercial paper on behalf of issuers, but instead only assists each issuer in placing these obligations privately with a limited number of institutional purchasers. In addition, the Board concludes that, based on, among other things, the bank's limited role in the commercial paper transactions and the unique operation of the recognized commercial paper market, Bankers Trust's limited placement of commercial paper will not give rise to the hazards and financial dangers that the Act was adopted to eliminate.

The Board's conclusions are based solely on the facts as contained in this Statement, and on the particular practices followed in placing commercial paper in the recognized commercial paper market. These conclusions may change if the functions described in that submission are materially altered, or if current practices in the commercial paper market change significantly.

Concurring Statement of Chairman Volcker

The issue facing the Board on remand in light of the Supreme Court's decision in the *Bankers Trust* case is a matter of application of the terms "selling," "underwriting" or "distributing" securities within the context of the Glass-Steagall Act. The specific question presented is whether extensions of credit by Bankers Trust to issuers of commercial paper placed by Bankers Trust as agent would, under certain circumstances, be the economic equivalent of the bank's investing its own funds to back the commercial paper. If so, my understanding is that placement of such paper would constitute "selling," "underwriting" or "distributing" for purposes of the Act.

In order to meet this concern, Bankers Trust has significantly modified its method of placing commercial paper so that it no longer extends short-term credit to issuers of commercial paper placed by the bank to cover unsold portions of the issue at rates of interest equal to or near the rates borne by the commercial paper it had sold. Moreover, the Bank stated that if it provides a line of credit to a commercial paper issuer it does so as part of its ordinary commercial lending function and that the decision to grant a line of credit is separate and independent from its commercial paper placement services.

The Board in its decision has gone further and required that advances of funds to an issuer under such a line of credit must be under different terms, at different times and for different purposes from the commercial paper placed by the bank. In addition, the Board would require the bank to keep appropriate records to demonstrate that loans were in fact granted independently of the Bank's role as commercial paper placement adviser. It has cited as examples of satisfactory evidence of this required independence, documented special purpose loans and loans in which there is substantial participation by other lenders, provided that both types of lending differed in terms of timing, maturity and interest rate from the commercial paper placed or outstanding. Finally, the Board requires, as a general matter, that the bank assure itself that any funds advanced to commercial paper issuers under any line of credit

not be used to repay any commercial paper of the issuer placed by the Bank to cover an unsold portion of a commercial paper issue placed by the Bank.

I believe that it is important to stress that these conditions be strictly adhered to in order to separate effectively the Bank's commercial lending function from its commercial paper placement services. I am prepared to concur in the Board's opinion only because the Board required application of these standards to assure this necessary separation.

While the requirements may thus be met for banks to conduct a commercial paper placement service under existing law, I believe that a more straightforward way of proceeding would be to obtain legislative authorization for banks to deal in and act as agents for the distribution of commercial paper. Congressional action is needed in order to provide a firm foundation of specifically applicable new law for the conduct of this activity, as well as to provide the Board with full authority to establish the necessary prudential framework.

**Order of the District Court,
October 19, 1984**

UNITED STATES DISTRICT COURT

FOR THE DISTRICT OF COLUMBIA

Civil Action No. 80-2730

A.G. BECKER, INC.,

Plaintiff,

v.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, *et al.*,

Defendants.

SECURITIES INDUSTRY ASSOCIATION,

Plaintiff,

v.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, *et al.*,

Defendants.

Filed October 19, 1984

ORDER

Following the Supreme Court's recent ruling in these consolidated actions, 52 U.S.L.W. 4943 (June 28, 1984), this matter is now before the Court on remand from the U.S. Court of

Appeals for the District of Columbia. Defendant Board of Governors of the Federal Reserve System has requested a further remand to the Board for consideration of the issue left undecided by the Supreme Court. Because a remand at this time would be both helpful and appropriate, this Court grants the defendant's motion.

The issue presented to the Supreme Court was whether commercial paper is a "security" under the Glass-Steagall Act. The Supreme Court reversed the decision of the D.C. Circuit and upheld the ruling of this Court that commercial paper is a "security" for purposes of the Act. The Supreme Court, however, did not decide whether the method Bankers Trust Company uses to place commercial paper with purchasers constitutes the "underwriting" of securities.

The "underwriting issue" has not previously been addressed by either this Court or the Board. In order to determine if the activity engaged in by Bankers Trust is in fact prohibited by the Glass-Steagall Act, it will be necessary at some point on remand to decide if Bankers Trust is in fact "underwriting" securities within the meaning of the Act.

In its decision the Supreme Court made clear that substantial deference must be given to the Board in interpreting a federal banking statute:

> '[T]he Board has primary responsibility for implementing the Glass-Steagall Act, and we accord substantial deference to the Board's interpretation of that Act whenever its interpretation provides a reasonable construction of the statutory language and is consistent with legislative intent.' *Securities Industry Ass'n v. Board of Governers, post*, at ____ (slip op. 9).

52 U.S.L.W. at 4945. This approach makes considerable sense, for with its background and experience in the federal banking area, the Board is better suited than the courts to draft findings and make initial rulings that deal with interpretations of the Glass-Steagall Act. Furthermore, uniformity and consistency in regulation is promoted if the Board is given the opportunity to consult with the agencies and reach its own conclusions

before a new issue of interpretation is decided. It is for these reasons that the Court has concluded that a further remand to the Board is both necessary and proper at this time.

The Court, however, is not unmindful of the length of time that it has taken for this case to wind its way through various levels of judicial and administrative tribunals. Confident that the Board, having requested this remand, fully acknowledges the need for expeditious resolution of this matter and will act with appropriate dispatch, the Court grants this remand to the Board and will retain jurisdiction pending the outcome before the Board. The Court hereby directs counsel for both sides to report to the Court within 45 days as to the progress of the litigation.

IT IS SO ORDERED this 19th day of October, 1984.

/s/ Joyce Hens Green

JOYCE HENS GREEN
United States District Judge

**Order of the Court of Appeals,
August 6, 1984**

UNITED STATES COURT OF APPEALS

FOR THE DISTRICT OF COLUMBIA CIRCUIT
September Term 1983

No. 83-2258

A.G. BECKER INCORPORATED,

Petitioner,

v.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, *et al.*,

Respondents.

And Consolidated Cases

Filed August 6, 1984

BEFORE:

Tamm and Wilkey, *Circuit Judges*,
and Robb, *Senior Circuit Judge*

ORDER

Upon consideration of Petitioners' motion for further remand, filed herein July 24, 1984, and it appearing that the mandate of the Supreme Court of the United States has been returned to this Court and for good cause shown, it is

ORDERED, by the Court, that Petitioners' motion is granted and this case is remanded to the United States District Court for the District of Columbia for further proceedings consistent with the opinion of the Supreme Court filed June 28, 1984.

Per Curiam

For the Court:

GEORGE A. FISHER,
Clerk

Opinion of the Supreme Court, June 28, 1984

Syllabus

SECURITIES INDUSTRY ASSOCIATION ET AL. *v.* BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM ET AL.

CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 82-1766. Argued March 21, 1984—Decided June 28, 1984

Section 16 of the Banking Act of 1933 (Act), commonly known as the Glass-Steagall Act, prohibits commercial banks from underwriting "securities or stock," and § 21 prohibits them from marketing "stocks, bonds, debentures, notes, or other securities." When Bankers Trust Co., a state commercial bank that is a member of the Federal Reserve System, began serving as agent for several of its corporate customers and marketing their commercial paper, petitioners (a national securities-industry trade association and a dealer in commercial paper) petitioned the Federal Reserve Board for a ruling that such activities were unlawful under §§ 16 and 21. Taking the position that if a particular kind of financial instrument evidences a transaction that is more functionally similar to a traditional commercial banking operation than to an investment transaction, then the instrument should not be viewed as a "security" for purposes of the Act, the Board concluded that commercial paper more closely resembles a commercial bank loan than an investment transaction and that it is not a "security" or "note" within the meaning of the Act and hence falls outside its proscriptions. The District Court disagreed, but the Court of Appeals deferred to the Board's interpretation and reversed the District Court's judgment.

Held: Because commercial paper falls within the plain language of the Act, and because the inclusion of commercial paper within the terms of the Act is fully consistent with its purposes, commercial paper is a "security" under the Act and therefore is subject to its proscriptions. Pp. 142-160.

(a) Although the Board's interpretation of the Act is entitled to substantial deference, this case presents considerations that counsel against giving full deference to that interpretation. The Board at the administrative level took the position that commercial paper was not a "security" within the meaning of the Act and that therefore it was unnecessary to examine the dangers that the Act was intended to eliminate, but before this Court the Board insisted that Bankers Trust's activities involved none of such dangers. *Post hoc* rationalizations by counsel for agency action are entitled to little deference. Pp. 142-144.

(b) In enacting the Act, Congress' worries about commercial-bank involvement in investment-bank activities reflected two general concerns. The first of these concerns was that a commercial bank might experience large losses from investing its funds in speculative securities. In addition to this concern, however, Congress focused on the conflicts of interest that arise when a commercial bank goes beyond the business of acting as a fiduciary or managing agent and develops a pecuniary interest in marketing securities. The Act's design reflects the congressional perception that some commercial- and investment-banking activities are fundamentally incompatible and justify a strong prophylaxis. Pp. 144–148.

(c) There is nothing in the language of either § 16 or § 21 to suggest a narrow reading of the word "securities," *i.e.*, that because the word appears in a phrase that includes "stocks, bonds, [and] debentures," the Act's prohibitions apply only to "notes [and] other securities" that resemble the enumerated instruments. To the contrary, the breadth of the term "securities" is implicit in the fact that the antecedent language encompasses not only equity securities but also securities representing debt. While the Act does not define the terms "notes" or "other securities," there is considerable evidence, particularly with respect to other Acts enacted at the same time that do define "security" to include commercial paper, to indicate that the ordinary meaning of the terms "securities" and "notes" as used in the Act encompasses commercial paper. The Board's interpretation effectively converts a portion of the Act's broad prohibitions into a system of administrative regulation, since by concluding that commercial paper is not covered by the Act, the Board in effect has obtained authority to regulate the marketing of commercial paper under its general supervisory power over member banks. Pp. 148–154.

(d) By focusing entirely on the nature of the financial instrument and ignoring the bank's role in the transaction, the Board's "functional analysis" misapprehends Congress' concerns with commercial-bank involvement in marketing securities. The facts that commercial paper is relatively low risk, that commercial banks traditionally have acquired commercial paper for their own accounts, or that commercial paper is sold largely to "sophisticated" investors, do not justify the Board's interpretation of the Act. There is little evidence to suggest that Congress intended the Act's prohibitions on underwriting to depend on the safety of particular securities. The authority to discount commercial paper is very different from the authority to underwrite it, and the Act admits of no exception to the prohibition on commercial-bank underwriting according to the particular investment expertise of the customer. Pp. 154–160.

224 U. S. App. D. C. 21, 693 F. 2d 136, reversed and remanded.

BLACKMUN, J., delivered the opinion of the Court, in which BURGER, C. J., and WHITE, MARSHALL, POWELL, and REHNQUIST, JJ., joined. O'CONNOR, J., filed a dissenting opinion, in which BRENNAN and STEVENS, JJ., joined, *post*, p. 160.

Harvey L. Pitt argued the cause for petitioners. With him on the briefs for petitioner A. G. Becker Incorporated were *Henry A. Hubschman*, *David M. Miles*, and *Laurence H. Tribe*. *James B. Weidner*, *John M. Liftin*, *William J. Fitzpatrick*, and *Donald J. Crawford* filed briefs for petitioner Securities Industry Association.

Deputy Solicitor General Claiborne argued the cause for respondents. With him on the brief were *Solicitor General Lee*, *Acting Assistant Attorney General Willard*, *Barbara E. Etkind*, and *Anthony J. Steinmeyer*.*

JUSTICE BLACKMUN delivered the opinion of the Court.

This case involves a challenge to the efforts of a state commercial bank to enter the business of selling third-party commercial paper. The Board of Governors of the Federal Reserve System (Board) concluded that such activity by state member banks is not prohibited by the Banking Act of 1933, ch. 89, 48 Stat. 162 (commonly known as the Glass-Steagall Act) because commercial paper is neither a "security" nor a "note" within the meaning of that Act and therefore falls outside the Act's proscriptions. The District Court disagreed with the Board, but the Court of Appeals deferred to the Board's interpretation and reversed the judgment of the District Court. Because commercial paper falls within

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*Briefs of *amici curiae* urging reversal were filed for Goldman, Sachs & Co. by *G. Duane Vieth*, *Leonard H. Becker*, and *Joseph McLaughlin*; and for the Investment Company Institute by *Louis Loss* and *Thomas D. Maher*.

Briefs of *amici curiae* urging affirmance were filed for Bankers Trust Co. by *John W. Barnum* and *Jennifer A. Sullivan*; and for the New York Clearing House Association et al. by *Robert S. Rifkind*, *William H. Smith*, and *Michael F. Crotty*.

the plain language of the Act, and because the inclusion of commercial paper within the terms of the Act is fully consistent with the Act's purposes, we conclude that commercial paper is a "security" under the Glass-Steagall Act, and we reverse the judgment of the Court of Appeals.

I

During 1978 Bankers Trust Company (Bankers Trust), a New York-chartered member bank of the Federal Reserve System, began serving as agent for several of its corporate customers in placing their commercial paper[1] in the commercial-paper market. Petitioners, the Securities Industry Association (SIA), a national securities-industry trade association, and A. G. Becker, Inc. (Becker), a dealer in commercial paper, informally expressed concern to the Board about Bankers Trust's commercial-paper activities. SIA and Becker subsequently petitioned the Board for, among other things, a ruling that Bankers Trust's activities are unlawful under §§16 and 21 of the Act, 12 U. S. C. §§24 Seventh and 378(a)(1). Section 16 prohibits commercial banks from underwriting "securities or stock," while §21 prohibits them from marketing "stocks, bonds, debentures, notes, or other securities." Petitioners asserted that Bankers Trust's activities violated both §§16 and 21.

On September 26, 1980, the Board responded to petitioners' request for enforcement of §§16 and 21 against Bankers Trust. See Federal Reserve System, Statement Regarding Petitions to Initiate Enforcement Action (1980), App. 122A (Board Statement). The Board acknowledged that Congress enacted the Act to prevent commercial banks from engaging

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[1] "Commercial paper" refers generally to unsecured, short-term promissory notes issued by commercial entities. Such a note is payable to the bearer on a stated maturity date. Maturities vary considerably, but typically are less than nine months. See generally, Hurley, The Commercial Paper Market, 63 Fed. Res. Bull. 525 (1977); Comment, The Commercial Paper Market and the Securities Acts, 39 U. Chi. L. Rev. 362, 363–364 (1972).

in certain investment-banking activities, but explained that Congress did not intend the Act's prohibitions to cover every instrument that could be characterized as a "note" or "security." The Board expressed concern that such a broad interpretation might preclude commercial banks from maintaining many of their traditional activities. Accordingly, the Board took the position that "if a particular kind of financial instrument evidences a transaction that is more functionally similar to a traditional commercial banking operation than to an investment transaction, then fidelity to the purposes of the Act would dictate that the instrument should not be viewed as a security." *Id.*, at 135A. Applying this "functional analysis" to commercial paper, the Board concluded that such paper more closely resembles a commercial bank loan than an investment transaction and that it is not a "security" for purposes of the Glass-Steagall Act. Because of this determination, the Board did not consider whether Bankers Trust's involvement with commercial paper constitutes "underwriting," within the meaning of the Act.

Petitioners challenged the Board's ruling in the United States District Court for the District of Columbia under, *inter alia*, the judicial-review provisions of the Administrative Procedure Act, 5 U. S. C. § 701 *et seq.*, claiming that the ruling was contrary to law. The District Court reversed the ruling, finding that commercial paper falls within the scope of § 21's reference to "notes . . . or other securities." *A. G. Becker Inc.* v. *Board of Governors of Federal Reserve System*, 519 F. Supp. 602, 612 (1981). The court also found error in the Board's "functional analysis" because it focused exclusively on the role that commercial paper plays in the financial affairs of the issuer. This approach ignored the commercial bank's role in the transaction, which the District Court concluded is a central concern of the Act. *Id.*, at 615–616.

The United States Court of Appeals for the District of Columbia Circuit, by a divided vote, reversed the judgment of the District Court. *A. G. Becker Inc.* v. *Board of Governors*

of Federal Reserve System, 224 U. S. App. D. C. 21, 693 F. 2d 136 (1982). The Court of Appeals' majority acknowledged that § 21's reference to "notes" was broad enough to include commercial paper, which is a promissory note. The court explained, however, that the term "note" was also susceptible of a narrower reading, limited to long-term debt securities closely resembling a bond or debenture but of shorter maturity. *Id.*, at 28–29, 693 F. 2d, at 143–144. Because the legislative history of the Act indicates that the 1933 Congress sought to encourage commercial banks to invest more heavily in commercial paper than in longer-term, more speculative securities, the court concluded that Congress used the term "notes" in § 21 in this narrower sense. *Id.*, at 29–31, 693 F. 2d, at 144–146. Finally, the court endorsed the Board's functional analysis of commercial paper and concluded that commercial paper more closely resembled a loan than a security because of its low default rate, the large denominations in which it is issued, and the sophistication of its buyers. In the Court of Appeals' view, these features of commercial paper eliminate the concerns that moved Congress to pass the Glass-Steagall Act. *Id.*, at 32–36, 693 F. 2d, at 147–151.

Because of the importance of the issue for the Nation's financial markets, we granted certiorari. 464 U. S. 812 (1983).

II

The Board is the agency responsible for federal regulation of the national banking system, and its interpretation of a federal banking statute is entitled to substantial deference. As the Court states elsewhere today, "the Board has primary responsibility for implementing the Glass-Steagall Act, and we accord substantial deference to the Board's interpretation of that Act whenever its interpretation provides a reasonable construction of the statutory language and is consistent with legislative intent." No. 83–614, *Securities Industry Assn.* v. *Board of Governors of Federal Reserve System*, *post*, at 217. We also have made clear, however, that deference is

not to be a device that emasculates the significance of judicial review. Judicial deference to an agency's interpretation of a statute "only sets 'the framework for judicial analysis; it does not displace it.'" *United States* v. *Vogel Fertilizer Co.*, 455 U. S. 16, 24 (1982), quoting *United States* v. *Cartwright*, 411 U. S. 546, 550 (1973). A reviewing court "must reject administrative constructions of [a] statute, whether reached by adjudication or by rulemaking, that are inconsistent with the statutory mandate or that frustrate the policy that Congress sought to implement." *FEC* v. *Democratic Senatorial Campaign Committee*, 454 U. S. 27, 32 (1981).

Although these principles establish in general terms the appropriate standard of review, this case presents an additional consideration that counsels against full deference to the Board. At the administrative level, the Board took the position that commercial paper was not a "security" within the meaning of the Act, and that, therefore, it did "not appear necessary to examine the dangers that the Act was intended to eliminate." Board Statement, App. 140A.[2] Before this Court, however, the Board appears to have changed somewhat the nature of its argument. The Board's counsel now insists that the activities of Bankers Trust "involv[e] none of the 'hazards' that this Court identified" as the concerns at which the Act is aimed. Brief for Respondents 40. We previously have stated that *post hoc* rationalizations by counsel for agency action are entitled to little deference: "It is the administrative official and not appellate counsel who possesses

[2] Despite this conclusion, the Board responded to concerns that activity similar to that of Bankers Trust might give rise to the problems that the Act sought to avoid, and issued a policy statement with "guidelines" imposing conditions as to when state member banks may sell third-party commercial paper. See 46 Fed. Reg. 29333 (1981). The Board issued these guidelines pursuant to its supervisory authority over state member banks under §§ 9 and 11 of the Federal Reserve Act, 38 Stat. 259 and 261, as amended, 12 U. S. C. §§ 248, 321–338, and § 202 of the Financial Institutions Supervisory Act of 1966, 80 Stat. 1046, as amended, 12 U. S. C. § 1818(b).

the expertise that can enlighten and rationalize the search for the meaning and intent of Congress." *Investment Company Institute* v. *Camp*, 401 U. S. 617, 628 (1971); see also *Burlington Truck Lines, Inc.* v. *United States*, 371 U. S. 156, 168–169 (1962). As a result, the Board's presentation here of the policies behind the Act as they apply to this case is of less significance than it would be if it had occurred at the administrative level. Because of this apparent shift, moreover, the contours of the Board's present position are somewhat unclear; much of the Board's argument now addresses the particular characteristics of the commercial paper in this case, apparently leaving open the possibility that commercial paper with different characteristics would qualify as a "security" and be subject to the Glass-Steagall Act's proscriptions. See Brief for Respondents 33–44. To the extent that the Board has changed its position from that adopted at the administrative level, its interpretation is entitled to less weight.

III

A

In *Camp* this Court explored at some length the congressional concerns that produced the Glass-Steagall Act. Congress passed the Act in the aftermath of the banking collapse that produced the Great Depression of the 1930's. The Act responded to the opinion, widely expressed at the time, that much of the financial difficulty experienced by banks could be traced to their involvement in investment-banking activities both directly and through security affiliates. At the very least, Congress held the view that the extensive involvement by commercial banks had been unwise; some in Congress concluded that it had been illegal.[8] Senator Glass stated bluntly

[8] Several Members of Congress expressed the view that the securities activities of bank affiliates were unlawful because they were not authorized by the federal charters under which national banks operated or by the state charters under which state banks operated. See 75 Cong. Rec. 9887–9888 (1932) (remarks of Sen. Glass); *id.*, at 9911 (remarks of Sen. Bulkley).

that commercial-bank involvement in securities had made "one of the greatest contributions to the unprecedented disaster which has caused this almost incurable depression." 75 Cong. Rec. 9887 (1932).

Congressional worries about commercial-bank involvement in investment-bank activities reflected two general concerns. The first was the inherent risks of the securities business. Speculation in securities by banks and their affiliates during the speculative fever of the 1920's produced tremendous bank losses when the securities markets went sour.[4] In addition to the palpable effect that such losses had on the assets of affected banks, they also eroded the confidence of depositors in the safety of banks as depository institutions. This crisis of confidence contributed to the runs on the banks that proved so devastating to the solvency of many commercial banks.

But the dangers that Congress sought to eliminate through the Act were considerably more than the obvious risk that a bank could lose money by imprudent investment of its funds in speculative securities. The legislative history of the Act shows that Congress also focused on "the more subtle hazards that arise when a commercial bank goes beyond the business of acting as fiduciary or managing agent and enters the investment banking business." *Camp*, 401 U. S., at 630. The Glass-Steagall Act reflects the 1933 Congress' conclusion that certain investment-banking activities conflicted in fundamental ways with the institutional role of commercial banks.

The Act's legislative history is replete with references to the various conflicts of interest that Congress feared to be present when a single institution is involved in both investment and commercial banking. Congress observed that

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[4] The failure of the Bank of the United States, for example, was attributed largely to that bank's activities with respect to its numerous securities affiliates. Operation of the National and Federal Reserve Banking Systems: Hearings pursuant to S. Res. 71 before a Subcommittee of the Senate Committee on Banking and Currency, 71st Cong., 3d Sess., pts. 1, 7, pp. 116–117, 1017, 1068 (1931) (1931 Hearings).

commercial bankers serve as an important source of financial advice for their clients. They routinely advise clients on a variety of financial matters such as whether and how best to issue equity or debt securities. Congress concluded that it was unrealistic to expect a banker to give impartial advice about such matters if he stands to realize a profit from the underwriting or distribution of securities. See, *e. g.*, 75 Cong. Rec. 9912 (1932) (remarks of Sen. Bulkley). Some legislators noted that this conflict is exacerbated by the considerable fixed cost that a securities dealer must incur to build and maintain a securities-distribution system. Explaining this concern, Senator Bulkley, a major sponsor of the Act, described the pressures that commercial banks had experienced through their involvement in the distribution of securities:

> "In order to be efficient a securities department had to be developed; it had to have salesmen; and it had to have correspondent connections with smaller banks throughout the territory tributary to the great bank. Organizations were developed with enthusiasm and with efficiency. . . . But the sales departments were subject to fixed expenses which could not be reduced without the danger of so disrupting the organization as to put the institution at a disadvantage in competition with rival institutions. These expenses would turn the operation very quickly from a profit to a loss if there were not sufficient originations and underwritings to keep the sales departments busy." *Id.*, at 9911.

Congress also expressed concern that the involvement of a commercial bank in particular securities could compromise the objectivity of the bank's lending operations. Congress feared that the pressure to dispose of an issue of securities successfully might lead a bank to use its credit facilities to shore up a company whose securities the bank sought to distribute. See 1931 Hearings, pt. 7, p. 1064. Some in

Congress feared that a bank might even make unsound loans to companies in whose securities the bank has a stake or to a purchaser of securities that the bank seeks to distribute. *Ibid.* Alternatively, a bank with loans outstanding to a company might encourage the company to issue securities through the bank's distribution system in order to obtain the funds needed to repay bank loans. 75 Cong. Rec. 9912 (1932) (remarks of Sen. Bulkley). Congress also faced some evidence that banks had misused their trust departments to unload excessive holdings of undesirable securities. *Camp*, 401 U. S., at 633; 1931 Hearings, pt. 1, p. 237.

The Act's design reflects the congressional perception that certain investment-banking activities are fundamentally incompatible with commercial banking. After hearing much testimony concerning the appropriate form of a legislative response to the problems,[5] Congress rejected the view of those who preferred legislation that simply would regulate the underwriting activities of commercial banks. Congress chose instead a broad structural approach that would "surround the banking business with sound rules which recognize the imperfection of human nature that our bankers may not be led into temptation, the evil effect of which is sometimes so subtle as not to be easily recognized by the most honorable man." 75 Cong. Rec. 9912 (1932) (remarks of Sen. Bulkley). Through flat prohibitions, the Act sought to "separat[e] as completely as possible commercial from investment banking." *Board of Governors of Federal Reserve System* v.

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[5] See 1931 Hearings, pt. 1, pp. 19–22 (testimony of J. Pole, Comptroller of the Currency); *id.*, at 191–192 (testimony of A. Wiggin, chairman, Chase National Bank); *id.*, at 238–241 (testimony of B. Trafford, vice chairman, First National Bank of Boston); *id.*, pt. 2, pp. 301–304, 318 (testimony of C. Mitchell, chairman, National City Bank of New York); *id.*, at 356, 364–365 (testimony of O. Young, chairman, General Electric Co.); *id.*, pt. 3, at 539 (testimony of A. Pope, executive vice president, First National Old Colony Corp.).

Investment Company Institute, 450 U. S. 46, 70 (1981) *(ICI)*.[6] Such an approach was not without costs in terms of efficiency and competition, but the Act reflects the view that the subtle risks created by mixing the two activities justified a strong prophylaxis. *Camp*, 401 U. S., at 630.

B

Sections 16 and 21 of the Act are the principal provisions that demarcate the line separating commercial and investment banking. Section 16 limits the involvement of a commercial bank in the "business of dealing in stock and securities" and prohibits a national bank from buying securities, other than "investment securities," for its own account. 12 U. S. C. § 24 Seventh. In addition, the section includes the general provision that a national bank "shall not underwrite any issue of securities or stock." Section 5(c) of the Act, 12 U. S. C. § 335, makes § 16's limitations applicable to state banks that are members of the Federal Reserve System. It is therefore clear that Bankers Trust may not underwrite commercial paper if commercial paper is a "security" within the meaning of the Act.

Section 21 also separates investment and commercial banks, but does so from the perspective of investment banks. Congress designed § 21 to prevent persons engaged in specified investment-banking activities from entering the commercial-banking business. The section prohibits any person "engaged in the business of issuing, underwriting, selling, or distributing . . . stocks, bonds, debentures, notes, or other securities" from receiving deposits. Bankers Trust receives

[6] We recognize, of course, that there are some activities, such as the safekeeping of securities for customers, in which Congress concluded that both commercial and investment banks may safely engage. The Act merely reflects Congress' view that those investment-banking activities that it determined to be incompatible with prudent commercial banking, such as underwriting securities, created risks that were so subtle as to justify a broad prohibition.

deposits, and it therefore is clear that § 21's prohibitions apply to it.

Because § 16 and § 21 seek to draw the same line, the parties agree that the underwriting prohibitions described in the two sections are coextensive, and we shall assume that to be the case. In any event, because both § 16 and § 21 apply to Bankers Trust, its activities in this case are unlawful if prohibited by either section. The language of § 21 is perhaps the more helpful, however, because that section describes in greater detail the particular activities of investment banking that Congress found inconsistent with the activity of commercial banks.

It is common ground that the terms "stocks," "bonds," and "debentures" do not encompass commercial paper. The dispute in this case focuses instead on petitioners' claims that commercial paper constitutes a "note" within the meaning of § 21, and, if not, that it is nevertheless encompassed within the inclusive term "other securities." Thus, petitioners claim that the plain language of the Act makes untenable the Board's conclusion that commercial paper is not a "security" within the meaning of the Act. Petitioners contend further that the role played by Bankers Trust in placing the commercial paper of third parties is precisely what the Glass-Steagall Act sought to prohibit.

C

Neither the term "notes" nor the term "other securities" is defined by the statute. "This silence compels us to 'start with the assumption that the legislative purpose is expressed by the ordinary meaning of the words used.'" *Russello* v. *United States*, 464 U. S. 16, 21 (1983), quoting *Richards* v. *United States*, 369 U. S. 1, 9 (1962). Respondents do not dispute that commercial paper consists of unsecured promissory notes and falls within the general meaning of the term "notes." See Board Statement, App. 131A; see also Brief for Respondents 2. Respondents assert, however, that the context in which the term is used suggests that Congress

intended a narrower definition. Because the term appears in a phrase that includes "stocks, bonds, [and] debentures," the Board insists that the Act's prohibitions apply only to "notes [and] other securities" that resemble the enumerated financial instruments. The Board's position seems to be that because "stocks, bonds, [and] debentures" normally are considered "investments," the Act is meant to prohibit the underwriting of only those notes that "shar[e] that characteristic of an investment that is the common feature of each of the other enumerated instruments." Brief for Respondents 23. Applying that criterion to commercial paper, the Board maintains that commercial paper more closely resembles a commercial loan and that it is therefore not an investment of the kind that qualifies as a "security" under the Act.

For a variety of reasons, we find unpersuasive the notion that Congress used the terms "notes . . . or other securities" in the narrow sense that respondents suggest. First, the Court noted in *Camp* that "there is nothing in the phrasing of either § 16 or § 21 that suggests a narrow reading of the word 'securities.' To the contrary, the breadth of the term is implicit in the fact that the antecedent statutory language encompasses not only equity securities but also securities representing debt." 401 U. S., at 635.

There is, moreover, considerable evidence to indicate that the ordinary meaning of the terms "security" and "note" as used by the 1933 Congress encompasses commercial paper. Congress enacted the Glass-Steagall Act as one of several pieces of legislation collectively designed to restore public confidence in financial markets. See the Banking Act of 1933, ch. 89, 48 Stat. 162 (codified as amended in scattered sections of 12 U. S. C.); the Securities Act of 1933, 48 Stat. 74, 15 U. S. C. § 77a *et seq.;* the Securities Exchange Act of 1934, 48 Stat. 881, 15 U. S. C. § 78a *et seq.;* and the Public Utility Holding Company Act of 1935, 49 Stat. 803, 15 U. S. C. § 79a *et seq.* In each of these other statutes, the definition of the term "security" includes commercial paper,

and each statute contains explicit exceptions where Congress meant for the provisions of an Act not to apply to commercial paper.[7] These explicit exceptions demonstrate congressional cognizance of commercial paper and Congress' understanding that, unless modified, the use of the term "security" encompasses it.

The Securities Act of 1933, for example, defines the term "security" to include "any note." 15 U. S. C. § 77b(1). During the hearings on that Act, Senator Glass expressed dissatisfaction with that definition because it plainly did encompass commercial paper. With the support of the Board, he sought to amend the definition of the term to exclude commercial paper,[8] but Congress chose instead to exempt commercial paper from only the registration requirements of the statute, see 15 U. S. C. § 77c(a)(3),[9] while preserving application of the statute's antifraud provisions to all commercial-paper "securities." §§ 77*l*, 77q(c). Congress passed the Glass-Steagall Act two weeks later, and throughout consideration of that Act by the same Committees of the same Congress, the eponymous Senator Glass displayed no

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[7] See 15 U. S. C. § 77c(a)(3) (exempting certain "note[s]" with maturities of less than nine months from the definition of "security" for certain provisions of the Securities Act of 1933); 15 U. S. C. § 78c(a)(10) (exempting certain "note[s]" with maturities of less than nine months from the definition of "security" under the Securities Exchange Act of 1934); 15 U. S. C. § 79i(c)(3) (exempting "commercial paper and other securities" specified by the Securities and Exchange Commission from the Public Utility Holding Company Act's restriction prohibiting acquisition by a holding company of "securities").

[8] See Securities Act: Hearings on S. 875 before the Senate Committee on Banking and Currency, 73d Cong., 1st Sess., 98, 120 (1933); see also Federal Securities Act: Hearings on H. R. 4314 before the House Committee on Interstate and Foreign Commerce, 73d Cong., 1st Sess., 180–181 (1933).

[9] It is significant that the exemption for commercial paper is described using the term "note," plainly indicating that Congress understood the ordinary meaning of that term to encompass commercial paper.

similar concern over the ordinary meaning of the broad phrase "notes . . . or other securities" in § 21.

The difficulty with the Board's attempt to narrow the ordinary meaning of the statutory language is evidenced by the Board's unsuccessful efforts to articulate a meaningful distinction between notes that the Act purportedly covers and those it does not. In other statutes in which commercial paper is exempted from securities regulation, Congress either has identified a particular feature, such as maturity period, that defines the exempted class of "notes," or it has authorized a federal agency to define it through regulation. See n. 7, *supra*. The Glass-Steagall Act does neither, and the efforts by the Board and the Court of Appeals to provide a workable definition that excludes commercial paper have been fraught with uncertainty and inconsistency. The Court of Appeals concluded that the Act applies only to notes that are issued "to raise money available for an extended period of time as part of the corporation's capital structure." 693 F. 2d, at 143. It is not clear that such a distinction finds support even with reference to the statutory language from which it purportedly derives. There is no requirement, for example, that stocks, bonds, and debentures be used only to meet the capital requirements of a corporation, and, even if there were, the legislative history provides little evidence to suggest that such a distinction was one that Congress found significant.

The Board, in contrast, seems to have concluded that a note is covered by the Act only if the note is properly viewed as an "investment." The Board contends that this approach requires it to consider a "cluster" of the note's features, see Brief for Respondents 34, n. 60, such as its maturity period, its risk features, and its prospective purchasers. Stocks, bonds, and debentures display a wide range of each of these characteristics, however, and the Act's underwriting prohibition does not demonstrate any sensitivity to the characteristics of a particular issue; the Act simply prohibits com-

mercial banks from underwriting them all. Without some clearer directive from Congress that it intended the statutory terms to involve the nebulous inquiry described by the Board, we cannot endorse the Board's departure from the literal meaning of the Act. The Court, in another context, has said pertinently: "Had Congress intended so fundamental a distinction, it would have expressed that intent clearly in the statutory language or the legislative history. It did not do so, however, and it is not this Court's function 'to sit as a super-legislature,' *Griswold* v. *Connecticut*, 381 U. S. 479, 482 (1965), and create statutory distinctions where none were intended." *American Tobacco Co.* v. *Patterson*, 456 U. S. 63, 72, n. 6 (1982).

In this respect, we find ourselves in substantial agreement with petitioners' suggestion that the Board's interpretation effectively converts a portion of the Act's broad prohibition into a system of administrative regulation. By concluding that commercial paper is not covered by the Act, the Board in effect has obtained authority to regulate the marketing of commercial paper under its general supervisory power over member banks. The Board acknowledges that "the sale of third party commercial paper by a commercial bank could involve, at least in some circumstances, practices that are not consistent with principles of safe banking." Board Statement, App. 141A. In response to these concerns, the Board issued guidelines for state member banks explaining the circumstances in which they properly may place the commercial paper of third parties. See n. 2, *supra*.

Although the guidelines may be a sufficient regulatory response to the potential problems, Congress rejected a regulatory approach when it drafted the statute, and it has adhered to that rejection ever since. In 1935, for example, Congress refused to amend the Act to permit "national banks under regulations by the Comptroller of the Currency . . . to underwrite and sell bonds, debentures, and notes." H. R. Conf. Rep. No. 1822, 74th Cong., 1st Sess., 53 (1935). As recently

as 1980, Congress extended to the Comptroller of the Currency authority to issue such rules as were needed to "carry out the responsibilities of the office," but expressly continued to withhold from the Comptroller the authority to issue regulations concerning "securities activities of National Banks under the Act commonly known as the 'Glass-Steagall Act.'" Depository Institutions Deregulation and Monetary Control Act of 1980, § 708, 94 Stat. 188, 12 U. S. C. § 93a. When Congress has concluded that a particular form of notes should not be covered by the Act's prohibitions, it has amended the statute accordingly. See Banking Act of 1935, § 303(a), 49 Stat. 707, 12 U. S. C. § 378(a)(1) (exempting mortgage notes from the coverage of § 21). In the face of Congress' refusal to give the Board any rulemaking authority over the activities prohibited by the Act, we find it difficult to imagine that Congress intended the Board to engage in the subtle and ad hoc "functional analysis" described by the Board.

D

By focusing entirely on the nature of the financial instrument and ignoring the role of the bank in the transaction, moreover, the Board's "functional analysis" misapprehends Congress' concerns with commercial bank involvement in marketing securities. Both the Board and the Court of Appeals emphasized that Congress designed the Act to prevent future bank losses arising out of investments in speculative, long-term investments. This description of the Act's underlying concerns is perhaps accurate but somewhat incomplete. "[I]n enacting the Glass-Steagall Act, Congress contemplated other hazards in addition to the danger of banks using bank assets in imprudent securities investments." *ICI*, 450 U. S., at 66. The concern about commercial-bank underwriting activities derived from the perception that the role of a bank as a promoter of securities was fundamentally incompatible with its role as a disinterested lender and adviser. This Court explained in *Camp:*

"In sum, Congress acted to keep commercial banks out of the investment banking business largely because it believed that the promotional incentives of investment banking and the investment banker's pecuniary stake in the success of particular investment opportunities was destructive of prudent and disinterested commercial banking and of public confidence in the commercial banking system." 401 U. S., at 634.

At the administrative level, the Board expressly chose not to consider whether these concerns are present when a commercial bank has a pecuniary interest in promoting commercial paper. Board Statement, App. 140A. Although the Board indicates before this Court that such activities do not implicate the concerns of the Act, we are unpersuaded by this belated assertion. In adopting the Act, for example, Congress concluded that a bank's "salesman's interest" in an offering "might impair its ability to function as an impartial source of credit." *Camp*, 401 U. S., at 631. In the commercial-paper market, where the distribution of an issue depends heavily on the creditworthiness of the issuer, a bank presumably can enhance the marketability of an issue by extending backup credit to the issuer. Similarly, as a commercial bank finds itself in direct competition with other commercial-paper dealers, it may feel pressure to purchase unsold notes in order to demonstrate the reliability of its distribution system, even if the paper does not meet the bank's normal credit standards. Recognizing these pressures, this Court stated in *Camp:* "When a bank puts itself in competition with [securities dealers], the bank must make an accommodation to the kind of ground rules that Congress firmly concluded could not be prudently mixed with the business of commercial banking." *Id.*, at 637.

The 1933 Congress also was concerned that banks might use their relationships with depositors to facilitate the distribution of securities in which the bank has an interest, and

that the bank's depositors might lose confidence in the bank if the issuer should default on its obligations. See *id.*, at 631; 1931 Hearings, pt. 7, p. 1064. This concern would appear fully applicable to commercial-paper sales, because banks presumably will use their depositor lists as a prime source of customers for such sales. To the extent that a bank sells commercial paper to large bank depositors, the result of a loss of confidence in the bank would be especially severe.

By giving banks a pecuniary incentive in the marketing of a particular security, commercial-bank dealing in commercial paper also seems to produce precisely the conflict of interest that Congress feared would impair a commercial bank's ability to act as a source of disinterested financial advice. Senator Bulkley, during the debates on the Act, explained:

> "Obviously, the banker who has nothing to sell to his depositors is much better qualified to advise disinterestedly and to regard diligently the safety of depositors than the banker who uses the list of depositors in his savings department to distribute circulars concerning the advantages of this, that, or the other investment on which the bank is to receive an originating profit or an underwriting profit or a distribution profit or a trading profit or any combination of such profits." 75 Cong. Rec. 9912 (1932).

This conflict of interest becomes especially acute if a bank decides to distribute commercial paper on behalf of an issuer who intends to use the proceeds of the offering to retire a debt that the issuer owes the bank.

In addressing these concerns before this Court, the Board focuses primarily on the extremely low rate of default on prime-quality commercial paper. We do not doubt that the risk of default with commercial paper is relatively low—lower perhaps than with many bank loans. For several reasons, however, we find reliance on this characteristic misplaced. First, it is not clear that the Board's exemption of commercial paper from the proscriptions of the Act is limited to commer-

cial paper that is "prime." The statutory language admits of no distinction in this respect, and the logic of the Board's opinion must exempt all commercial paper from the prohibition on underwriting by commercial banks. Second, as described above, it appears that a bank can make a particular issue "prime" simply by extending backup credit to the issuer. Such a practice would seem to fit squarely within Congress' concern that banks would use their credit facilities to aid in the distribution of securities.

More importantly, however, there is little evidence to suggest that Congress intended the Act's prohibitions on underwriting to depend on the safety of particular securities. Stocks, bonds, and debentures exhibit the full range of risk; some are less risky than many of the loans made by a bank. And while the risk features of a security presumably affect whether it qualifies as an "investment security" that a commercial bank may purchase for its own account,[10] the Act's underwriting prohibition displays no appreciation for the features of a particular issue; the Act just prohibits commercial banks from underwriting any of them, with an exception for certain enumerated governmental obligations that Congress specifically has chosen to favor. See 12 U. S. C. § 24 Seventh. The Act's prophylactic prohibition on underwriting reflects Congress' conclusion that the mere existence of a securities operation, " 'no matter how carefully and conservatively run, is inconsistent with the best interests' " of the bank as a whole. 75 Cong. Rec. 9913 (1932) (remarks of Sen. Bulkley, quoting a statement issued by the Bank of Manhattan Trust Co.).

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[10] It is clear that Congress' concern with commercial-bank purchases of securities was different from its concern about commercial-bank involvement in securities underwriting activities. In 1938 Congress refused to report out of committee legislation that would have allowed national banks to "underwrite or participate in the underwriting of new issues of such securities as [they] may otherwise lawfully purchase for its own account." H. R. 9441, § 1(b), 75th Cong., 3d Sess. (1938).

In this regard, the Board's focus on the fact that commercial banks traditionally have acquired commercial paper for their own accounts is beside the point. It is clearly true, as the Board asserts before this Court, that Congress designed the Glass-Steagall Act to cause banks to invest more of their funds in short-term obligations like commercial paper instead of in longer term and more speculative securities. By so doing, Congress hoped to enhance the liquidity of funds and protect bank solvency. But the authority to discount commercial paper is very different from the authority to underwrite it. The former places banks in their traditional role as a prudent lender. The latter places a commercial bank in the role of an investment banker, which is precisely what Congress sought to prohibit in the Act.[11] See Note,

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[11] The Board makes an additional argument based on § 16's restrictions on securities purchases by commercial banks. Section 16 prohibits commercial banks from "dealing in securities" on their own account altogether, and permits them to "purchase for [their] own account" only "investment securities." The Board argues that commercial paper does not constitute an "investment security" within the meaning of that term in § 16, and hence that § 16 would not permit commercial banks to purchase commercial paper for their own account if commercial paper were classified as a "security." Because commercial banks traditionally *have* acquired commercial paper for their own account, and because that practice universally has been assumed not to run afoul of the Glass-Steagall Act, the Board argues that the practice cannot be reconciled with § 16 unless commercial paper is not deemed a "security." See Brief for Respondents 17–18, 26–30.

Even if the Board is correct that commercial paper is not an "investment security" under § 16, something that we need not decide, we find the Board's argument unpersuasive because it rests on the faulty premise that the process of acquiring commercial paper necessarily constitutes "the business of dealing" in securities. The underlying source of authority for national banks to conduct business is the first sentence of § 16, which originated as § 8 of the National Bank Act of 1864, ch. 106, 13 Stat. 101. That provision grants national banks the authority to exercise "all such incidental powers as shall be necessary to carry on the business of banking" and enumerates five constituent powers that constitute "the business of banking." One of those powers is "discounting and negotiating promissory notes." 12 U. S. C. § 24 Seventh. The Board appears to concede that the

A Conduct-Oriented Approach to the Glass-Steagall Act, 91 Yale L. J. 102 (1981); Comment, 9 J. Corp. L. 321 (1984).

The Board also seeks comfort in the fact that commercial paper is sold largely to "sophisticated" investors. Once again, however, the Act leaves little room for such an ad hoc analysis. In its prohibition on commercial-bank underwriting, the Act admits of no exception according to the particular investment expertise of the customer. The Act's prohibition on underwriting is a flat prohibition that applies to sales to both the knowledgeable and the naive. Congress expressed concern that commercial-bank involvement in securities operations threatened the ability of commercial banks to act as "financial confidant and mentor" for both "the poor widow" and "the great corporation." 75 Cong. Rec. 9912 (1932) (remarks of Sen. Bulkley). Even if purchaser-sophistication is relevant under the Act, moreover, it is not clear that commercial paper is sold only in large denominations, see Hicks, Commercial Paper: An Exempted Security Under Section 3(a)(3) of the Securities Act of 1933, 24 UCLA L. Rev. 227, 234, and n. 30 (1976), or only to sophisticated investors. See *Sanders* v. *John Nuveen & Co.*, 524 F. 2d 1064 (CA7 1975), vacated and remanded, 425 U. S. 929 (1976).

Finally, it is certainly not without some significance that Bankers Trust's commercial-paper placement activities ap-

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authority for national banks to acquire commercial paper is grounded in this authorization to discount promissory notes. See Brief for Respondents 18, n. 25. The subsequent prohibition on engaging in "[t]he business of dealing in securities" does not affect this authority; while the Glass-Steagall Act does not define the term "business of dealing" in securities, the term clearly does not include the activity of "discounting" promissory notes because that activity is defined to be a part of the "business of banking." In short, the fact that commercial banks properly are free to acquire commercial paper for their own account implies not that commercial paper is not a "security," but simply that the process of extending credit by "discounting" commercial paper is not part of the "business of dealing" in securities.

pear to be the first of that kind since the passage of the Act. The history of commercial-bank involvement in commercial paper prior to the Act is not well documented; evidently, commercial banks occasionally dealt in commercial paper, but their involvement was overwhelmingly in the role of discounter rather than dealer. See R. Foulke, The Commercial Paper Market 108 (1931); A. Greef, The Commercial Paper House in the United States 63, 403–405 (1938). Since enactment of the Act, however, there is no evidence of commercial-bank participation in the commercial-paper market as a dealer. The Board has not offered any explanation as to why commercial banks in the past have not ventured to test the limits of the Act's prohibitions on underwriting activities. Although such behavior is far from conclusive, it does support the view that when Congress sought to "separat[e] as completely as possible commercial from investment banking," *ICI*, 450 U. S., at 70, the banks regulated by the Act universally recognized that underwriting[12] commercial paper falls on the investment-banking side of the line.

IV

For the foregoing reasons, the judgment of the Court of Appeals is reversed, and the case is remanded for further proceedings consistent with this opinion.

It is so ordered.

JUSTICE O'CONNOR, with whom JUSTICE BRENNAN and JUSTICE STEVENS join, dissenting.

The question in this case is whether the Board of Governors of the Federal Reserve System (Board) adopted an erroneous interpretation of law when it concluded that

[12] Because of its conclusion that the commercial paper in this case was not a "security" under the Act, the Court of Appeals did not consider whether the activity of Bankers Trust constitutes "underwriting" within the meaning of § 16, or "the business of issuing, underwriting, selling, or distributing" within the meaning of § 21. We express no opinion on these matters, leaving them to be decided on remand.

commercial paper is not a "security" under, and hence is not subject to the proscriptions of, §§16 and 21 of the Glass-Steagall Act, 48 Stat. 184, 189, as amended, 12 U. S. C. §§24 Seventh and 378(a)(1). The area of banking law in which this question arises is as specialized and technical as the financial world it governs, and the relevant statutes are far from clear or easy to interpret. The question is accordingly one on which this Court must give substantial deference to the Board's construction. Because of the Board's expertise and experience in this complicated area of law, and because of its extensive responsibility for administering the federal banking laws, the Board's interpretation of the Glass-Steagall Act must be sustained unless it is unreasonable. No. 83–614, *Securities Industry Assn.* v. *Board of Governors of Federal Reserve System*, *post*, at 217, and n. 16; *Investment Company Institute* v. *Camp*, 401 U. S. 617, 626–627 (1971); see also *Chevron U. S. A. Inc.* v. *Natural Resources Defense Council, Inc.*, 467 U. S. 837, 844–845 (1984); *Board of Governors of Federal Reserve System* v. *Investment Company Institute*, 450 U. S. 46, 56–58 (1981); *FEC* v. *Democratic Senatorial Campaign Committee*, 454 U. S. 27, 39 (1981).

Analysis of this case requires simply an examination of the usual sources of statutory interpretation—primarily the statutory language—to determine whether the Board's reading is a reasonable one, even if it is not the only reasonable one. The Court of Appeals departed from this approach when it limited its approval of the Board's position to certain kinds of sales of certain kinds of commercial paper that it thought did not present certain dangers addressed by the Glass-Steagall Act, *A. G. Becker Inc.* v. *Board of Governors of Federal Reserve System*, 224 U. S. App. D. C. 21, 36–37, 693 F. 2d 136, 151–152 (1982), and the Solicitor General, though not actually adopting a similarly limited position on behalf of the Board, has devoted a significant portion of his brief in this Court to elaborating the safety analysis underlying the Court of Appeals' limitation, Brief for Respondents 33–44. It is the Board's position, however, and not that of the Court of

Appeals or of the Solicitor General, to which deference is due. It is the Board that has the experience, expertise, and responsibility that require us to give it "considerable deference in its interpretation of the statute." *United States* v. *Mitchell*, 445 U. S. 535, 550 (1980) (WHITE, J., dissenting).[1]

The Board's own careful and thorough opinion, I believe, amply demonstrates the reasonableness—perhaps the inevitability—of its construction of the critical statutory language. Moreover, the Court's construction of the statute and petitioners' objections to the Board's position are unpersuasive. In these circumstances, the Court should defer to the Board and uphold its ruling. Because the Court does not do so, I respectfully dissent.

I

The language of §§ 16 and 21 of the Glass-Steagall Act makes it clear that, in considering whether the Act prohibits a covered bank[2] from selling third-party commercial paper, the threshold issue is whether commercial paper is a "security" within the meaning of those two sections. See *Investment Company Institute* v. *Camp*, *supra*, at 634–635. If it is not, then commercial paper, which is a debt rather than an equity instrument, is not subject to § 16's regulation of commercial bank transactions in "securities and stock."[3] Nor

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[1] As petitioner A. G. Becker Inc. says, "[i]t is the Board's position in its ruling, of course, and not the post-hoc rationalization of its counsel, by which the Board's conduct must be judged." Reply Brief for Petitioner A. G. Becker Inc. 3, n. 5. See also *id.*, at 11, n. 23.

[2] All parties acknowledge that banks chartered under state law that are members of the Federal Reserve System, such as Bankers Trust Company, are covered by the Glass-Steagall Act by virtue of 48 Stat. 165, 12 U. S. C. § 335. See n. 12, *infra*.

[3] Section 16 of the Glass-Steagall Act reads, in relevant part:

"The business of dealing in securities and stock by [a national bank] shall be limited to purchasing and selling such securities and stock without recourse, solely upon the order, and for the account of, customers, and in no case for its own account, and the [national bank] shall not underwrite any

is it subject to § 21's regulation of transactions in "stocks, bonds, debentures, notes, or *other* securities." (Emphasis added.)[4] Section 21's use of the word "other" implies that no debt instrument is within the scope of the section unless it is also a "security."

Despite differences in language, moreover, §§ 16 and 21 are coextensive in their proscriptions of commercial banks' securities activities. The two provisions approach the same problem from different directions: broadly speaking, § 16 tells firms that engage in commercial banking that they cannot engage in certain securities activities; § 21 tells firms that engage in certain securities activities that they cannot engage in commercial banking. See *Board of Governors of Federal Reserve System* v. *Investment Company Institute*,

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issue of securities or stock: *Provided*, That the [national bank] may purchase for its own account investment securities under such limitations and restrictions as the Comptroller of the Currency may by regulation prescribe. . . . As used in this section the term 'investment securities' shall mean marketable obligations evidencing indebtedness of any person, copartnership, association, or corporation in the form of bonds, notes and/or debentures commonly known as investment securities under such further definition of the term 'investment securities' as may by regulation be prescribed by the Comptroller of the Currency." 12 U. S. C. § 24 Seventh.

[4] Section 21 of the Glass-Steagall Act reads, in relevant part:

"[I]t shall be unlawful . . . [f]or any person, firm, corporation, association, business trust, or other similar organization, engaged in the business of issuing, underwriting, selling, or distributing, at wholesale or retail, or through syndicate participation, stocks, bonds, debentures, notes, or other securities, to engage at the same time to any extent whatever in the business of receiving deposits subject to check or to repayment upon presentation of a passbook, certificate of deposit, or other evidence of debt, or upon request of the depositor: *Provided*, That the provisions of this paragraph shall not prohibit national banks or State banks or trust companies (whether or not members of the Federal Reserve System) or other financial institutions or private bankers from dealing in, underwriting, purchasing, and selling investment securities, or issuing securities, to the extent permitted to national banking associations by the provisions of [§ 16]." 12 U. S. C. § 378(a)(1).

450 U. S., at 62–63. Moreover, § 21 itself contains a proviso intended "to make it clear that the prohibition in Section 21 [does] not prohibit banks from conducting those securities activities permitted by Section 16." 5 V. DiLorenzo, W. Schlichting, T. Rice, & J. Cooper, Banking Law § 96.02[2], p. 96–15 (1981) (footnote omitted). See H. R. Rep. No. 742, 74th Cong., 1st Sess., 16 (1935) (hereinafter H. R. Rep. No. 742); S. Rep. No. 1007, 74th Cong., 1st Sess., 15 (1935) (hereinafter S. Rep. No. 1007).[5] Indeed, petitioners concede that §§ 16 and 21 proscribe the same securities activities by commercial banks. See Brief for Petitioner A. G. Becker Inc. 24; Brief for Petitioner Securities Industry Association 12. For this reason, the language of both provisions must be examined to determine the intended coverage of the Glass-Steagall Act.

It is apparent from the statutory language that there is no "plain meaning" of the key terms in either § 16 or § 21 that forecloses the Board's interpretation. The Glass-Steagall Act nowhere defines the term "securities," and the term is not so well defined, either generally or as a legal term of art, that commercial paper is plainly included within its meaning. In particular, nothing on the face of the Glass-Steagall Act reveals whether "securities" refers to the class of all written instruments evidencing a financial interest in a business or, alternatively, to a narrower class of capital-raising investment instruments, as opposed to instruments evidencing short-term loans used to fund current expenses. The term "notes" in § 21, on which petitioners rest their argument that the Glass-Steagall Act covers commercial paper, is likewise susceptible to different meanings. Although "note" is often used generically to refer to any written promise to pay a specified sum on demand or at a specified time, see Uniform

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[5] Section 21 states that its provisions "shall not prohibit national banks or State banks . . . from dealing in, underwriting, purchasing, and selling investment securities, or issuing securities, to the extent permitted" by § 16. 12 U. S. C. § 378(a)(1).

Commercial Code §3–104, 2 U. L. A. 17 (1977); Black's Law Dictionary 956 (5th ed. 1979); G. Munn & F. Garcia, Encyclopedia of Banking and Finance 724–725 (8th ed. 1983), it is also used, more narrowly, to refer to a particular kind of capital-raising debt instrument distributed under an indenture agreement, like bonds or debentures but of shorter maturity, see *id.*, at 725 ("The term note also is sometimes applied to short-term bonds . . ."); 1 A. Dewing, The Financial Policy of Corporations 178 (5th ed. 1953).[6] Commercial paper, which consists of "prime quality, negotiable, usually unsecured short-term promissory notes issued by business organizations to meet part of their short-term credit needs," App. to Pet. for Cert. 65a (footnote omitted), does not come within the narrower interpretations of either "securities" or "notes." Thus, the words "securities" and "notes" in §§16 and 21, considered alone, are susceptible to the Board's construction.

Not only do the key terms of §§16 and 21, read in isolation, admit the Board's interpretation, but the provisions as a whole lend strong, perhaps decisive, support to the Board's view. A reading of §§16 and 21 reveals that petitioners' interpretation, like any other interpretation that treats commercial paper as a "security," does violence to the statutory language. And the Board's interpretation makes sense of the statutory language and of its history.

Section 21. Petitioners pin almost their entire statutory-language argument on the contention that §21 uses the term "notes" in its generic sense, as comprising all written promises to pay a specified sum on demand or at a specified time. Aside from the absence of any affirmative evidence favoring that interpretation, there are several reasons to think that petitioners' contention about the broad meaning of "notes" is

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[6] The 1934 edition of Dewing's classic work, contemporaneous with the 1933 Glass-Steagall Act, contains the same reference to short-term bonds as "notes." A. Dewing, The Financial Policy of Corporations 75 (3d rev. ed. 1934). See also H. Moulton, The Financial Organization of Society 111–118 (2d ed. 1925); E. Mead, Corporation Finance 301 (rev. ed. 1919).

erroneous. First, § 21's mention of bonds and debentures—both of which are written promises to pay a specified sum on demand or on a specified date, see 1 Dewing, *supra*, at 169, 226—would be redundant if "notes" were as sweeping in its scope as petitioners suggest. Second, and more important, if § 21 included all written promises to pay a specified sum on demand or at a specified time, it would apply to such instruments as certificates of deposit, notes representing a bank loan to a business, bankers' acceptances, and loan participations. See Note, 91 Yale L. J. 102, 118–119, and nn. 126–129 (1981). Yet such a construction of "notes" would render unlawful much banking activity that not even petitioners urge is anything but legitimate commercial banking. For example, petitioners' reading of § 21 would make it "unlawful . . . [f]or any person . . . engaged in the business of issuing, . . . selling, or distributing . . . [certificates of deposit or bankers' acceptances] . . . to engage at the same time to any extent whatever in the business of receiving deposits . . . ." 12 U. S. C. § 378(a)(1).[7] In short, petitioners' reading of § 21 makes nonsense of the statutory language, and it therefore cannot be correct. The Board's reading, the only alternative to petitioners', gains considerable support from this conclusion.

Finally, the language of § 21 provides affirmative support for the reasonableness of the Board's position that "notes" refers only to instruments characterizable as short-term bonds or debentures. In No. 83–614, *Securities Industry Assn.* v. *Board of Governors of Federal Reserve System*, *post*,

[7] Petitioners conceded at oral argument that certificates of deposit, for example, were notes in the generic sense of that term. See Tr. of Oral Arg. 14. The technical definition of "note" in the Uniform Commercial Code distinguishes certificates of deposit, but it does so only to define a specific class of bank-issued promises to pay money, not because a certificate of deposit is not otherwise a written promise to pay a specified sum on demand or on a specified date. See Uniform Commercial Code § 3–104, 2 U. L. A. 17 (1977).

p. 207, we rely on the "'familiar principle of statutory construction that words grouped in a list should be given related meaning,'" to support our conclusion that the Board reasonably construed the term "public sale" in § 20 of the Glass-Steagall Act, 12 U. S. C. § 377, "to refer to the underwriting activity described by the terms that surround it." *Post*, at 218 (quoting *Third National Bank* v. *Impac, Ltd.*, 432 U. S. 312, 322 (1977)). The same principle is relevant in this case. That stocks, bonds, and debentures are all instruments purchased for investment purposes suggests that "notes" should be read to refer only to instruments similarly purchased for investment purposes. More specifically, the listing of bonds, debentures, and notes as the three "securities" (as opposed to "stock") named in § 21 suggests that the ambiguity in "notes" should be resolved, as the Board has done, by reading the term to refer to instruments similar in character to bonds and debentures. In sum, the Board's position makes good sense of § 21's list of financial instruments by giving the items in the list related meanings.

Section 16. The language of § 16, like that of § 21, cannot bear petitioners' construction. Any reading of § 16 that deems commercial paper a "security" leaves federal banking law laden with contradictions.

Section 16 flatly forbids covered banks to purchase "securities and stock" for their own accounts, but it makes a limited exception for "investment securities." See n. 3, *supra*.[8] It

[8] The Court suggests that § 16's reference to the "business of dealing in securities and stock" means that § 16 does not flatly prohibit covered banks from purchasing securities and stock for their own accounts, except as authorized by the proviso, but only from the "business of dealing" in them. *Ante*, at 158–159. Not even petitioners, however, dispute the proposition that § 16 constitutes a flat ban on purchasing, subject to the proviso. Indeed, the legislative history makes clear that Congress so intended § 16. In particular, stock, which is not subject to the proviso, simply may not be purchased by commercial banks for their own accounts. See S. Rep. No. 77, 73d Cong., 1st Sess., 16 (1933); S. Rep. No. 1007,

is undisputed that commercial banks may purchase commercial paper for their own accounts.[9] Hence, if commercial paper is a "security" within the meaning of § 16, it must be an "investment security." To put the same point in the reverse order, if commercial paper is not an "investment security," it cannot be a security covered by § 16 at all: otherwise, contrary to what even petitioners acknowledge to be so, banks could not buy it for their own accounts. The Board concluded that commercial paper is not an "investment security," and therefore is not a "security," under § 16, App. to Pet. for Cert. 69a–74a, and that conclusion is at the very least a reasonable one. Petitioners nowhere dispute the conclusion that commercial paper is not an investment security; indeed, they effectively concede that it is correct. See Tr. of Oral Arg. 7.

The reasons may be briefly summarized. Section 16 defines "investment security" to mean "marketable obligations, evidencing indebtedness of any person, copartnership, asso-

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p. 17; H. R. Rep. No. 742, p. 18; 5 V. DiLorenzo, W. Schlichting, T. Rice, & J. Cooper, Banking Law § 96.02[2], p. 96–16 (1981).

The Court also treats the purchasing and underwriting prohibitions in the Act as if they were entirely separate. See *ante*, at 158–159. That treatment is inconsistent with the statutory language. There is no escaping the fact that any "security" that the Act forbids a commercial bank to underwrite the Act also forbids the bank to purchase, unless it is an investment security. Although the purposes of the prohibitions are somewhat different, the link between the prohibitions, at least as far as this case is concerned, is indissoluble.

[9] Indeed, the Board observed that commercial banks have long purchased commercial paper for their own accounts. See App. to Pet. for Cert. 74a, n. 17. See also A. Greef, The Commercial Paper House in the United States 95–96 (1938); R. Foulke, The Commercial Paper Market 65–74 (1931). No one in this litigation or anywhere else has ever suggested that commercial banks do not "purchase" commercial paper. Indeed, not only do the Board and the standard histories of commercial paper refer to banks' "purchasing" of commercial paper, see, *e. g.*, App. to Pet. for Cert. 74a, n. 17; Greef, *supra*, at 292–325, 335–346; Foulke, *supra*, at 65–98, but so too do petitioners, see Brief for Petitioner A. G. Becker Inc. 39; Brief for Petitioner Securities Industry Association 28; Reply Brief for Petitioner Securities Industry Association 3.

ciation, or corporation in the form of bonds, notes and/or debentures commonly known as investment securities under such further definition of the term . . . as may by regulation be prescribed by the Comptroller of the Currency." 12 U. S. C. § 24 Seventh. The Comptroller has never designated commercial paper as an investment security. Moreover, in 1971 the Comptroller's Chief Counsel took the position that commercial paper does not constitute an investment security. See App. to Pet. for Cert. 73a. In addition, the federal banking regulators, including the Comptroller, have always treated a bank's purchase of commercial paper as a loan: it must be treated as such in federally required bank reports, and the Comptroller views the statutory limits on loans to individual borrowers, 12 U. S. C. § 84, as distinct from § 16's limits on holding investment securities of a single issuer, 12 CFR § 7.1180 (1983). See App. to Pet. for Cert. 72a–73a.

History also supports the Board's conclusion that commercial paper is not an investment security. The phrase "investment security" originated in the McFadden Act of 1927, 44 Stat. (part 2) 1224, and the Glass-Steagall Act did not purport to alter the meaning of the phrase. The McFadden Act affirmed the authority of national banks to deal in "investment securities," subject to certain restrictions: it was intended to provide express statutory authorization for national banks' longstanding practice of dealing in corporate bonds. See H. R. Rep. No. 83, 69th Cong., 1st Sess., 3–4 (1926). Congressman McFadden, the sponsor of the Act, expressly stated during floor debate on the bill that commercial paper had not been and would not be regarded as an "investment security" and hence would be subject to the statutory limitations on loans, not to the restrictions of the McFadden Act. 67 Cong. Rec. 3232 (1926). This statement, which was not disputed by anyone in Congress, accurately reflects the fact that banks' involvement with commercial paper had long been understood as distinct from their involvement with investment instruments, since the purchase of commercial

paper was regarded as the making of a short-term loan rather than as an investment.[10] Indeed, as the Board pointed out, "historical studies of the commercial paper market . . . indicate that banks purchased and sold commercial paper (and served as commercial paper dealers) pursuant to their lending functions long before commercial banks began expanding their activities into the underwriting of corporate bonds and other debt obligations after the Civil War, activities that were restricted by the McFadden legislation concerning investment securities and, six years later, by the Glass-Steagall Act." App. to Pet. for Cert. 72a; see *id.*, at 72a, n. 13 (citing, *inter alia*, Greef, *supra* n. 9, at 6–7, 15–18, 63, 403–405; Foulke, *supra* n. 9, at 108). In sum, commercial paper has never been treated, and was not intended to be treated, as an investment security under either the McFadden or the Glass-Steagall Acts. Given that banks covered by § 16 have the authority to purchase commercial paper for their own accounts, which they could not do if commercial paper were a security under § 16, it follows that commercial paper cannot be a security within the meaning of the Glass-Steagall Act.

Having established that commercial paper is not an "investment security," it is also possible to draw support for the Board's conclusion from the original 1933 language of § 16. As enacted in 1933, § 16 prohibited national banks from purchasing "investment securities" for their own account and

[10] In order for commercial paper to be eligible for discount at Federal Reserve banks, its proceeds may not "be used for permanent or fixed investments of any kind, such as land, buildings, or machinery, or for any other fixed capital purpose" or "for transactions of a purely speculative character" or "for . . . trading in . . . investment securities except direct obligations of the United States." Consistent with the short maturity of commercial paper, the proceeds must be used "in producing, purchasing, carrying, or marketing goods," "meeting current operating expenses," or "carrying or trading in direct obligations of the United States." G. Munn & F. Garcia, Encyclopedia of Banking and Finance 196 (8th ed. 1983).

from underwriting any "issue of securities," but the proviso permitted the purchase of "investment securities" subject to the regulation of the Comptroller of the Currency.[11] Thus, the original version of § 16 simply does not apply to any instrument, like commercial paper, that is not an investment security. In 1935 Congress altered this language, but it did so simply "to make it clear that national banks and other member banks may purchase and sell stocks for the account of their customers but not for their own accounts." H. R. Rep. No. 742, p. 18. See also S. Rep. No. 1007, p. 16. Congress had no intent to change the coverage of § 16 with respect to nonequity instruments. In short, the 1933 version of § 16, which was unaltered in any respect relevant to commercial paper, lends strong support to the Board's position that the Glass-Steagall Act does not apply to commercial paper, which is not an "investment security."

Indeed, there is good reason to think that Congress understood the term "securities" to mean nothing broader than "investment securities." First, the 1935 amendment to § 16 substituted "securities and stock" for "investment securities" without suggesting that § 16's application to nonequity instruments was being in any way expanded. Similarly, the

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[11] Section 16 of the Glass-Steagall Act as enacted in 1933 reads, in relevant part:

"The business of dealing in investment securities by the [bank] shall be limited to purchasing and selling such securities without recourse, solely upon the order, and for the account of, customers, and in no case for its own account, and the [bank] shall not underwrite any issue of securities; *Provided*, That the [bank] may purchase for its own account investment securities under such limitations and restrictions as the Comptroller of the Currency may by regulation prescribe .... As used in this section the term 'investment securities' shall mean marketable obligations evidencing indebtedness of any person, copartnership, association, or corporation in the form of bonds, notes and/or debentures commonly known as investment securities under such further definition of the term 'investment securities' as may by regulation be prescribed by the Comptroller of the Currency." 48 Stat. 184.

proviso in § 21, see n. 5, *supra*, enacted into law in 1935 along with the amendment to § 16, refers only to "investment securities" insofar as it addresses banks' "dealing in, underwriting, purchasing, and selling"; yet it is clear, and it is conceded, that the proviso was intended to make § 21's prohibitions coextensive with those of § 16 with respect to all securities activities. See H. R. Rep. No. 742, p. 16 (amendment makes clear that § 21 "does not prohibit any financial institution or private banker from engaging in the securities business to the limited extent permitted to national banks under [§ 16]"); S. Rep. No. 1007, p. 15 (amendment provides that § 21 "should not be construed as prohibiting banks, bankers, or financial institutions from engaging in securities activities within the limits expressly permitted in the case of national banks under [§ 16]"). Moreover, § 5(c) of the Glass-Steagall Act likewise refers only to "investment securities and stock";[12] yet that provision, as petitioners concede, makes § 16 of the Glass-Steagall Act applicable in full to "state member banks" like the Bankers Trust Company, see Brief for Petitioner A. G. Becker Inc. 2, n. 2; Brief for Petitioner Securities Industry Association 3, n. 3. All of these congressional enactments presuppose that Congress understood "securities" and "investment securities" to refer to the same class of debt instruments, a class that excludes commercial paper.

This conclusion confirms the Board's view that §§ 16 and 21, as amended in 1935, were intended to apply only to investment instruments akin to stocks, bonds, and debentures. It also comports with what the legislative history reveals to have been of concern to the Congress that enacted Glass-Steagall. During the extensive legislative hearings and

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[12] Section 5(c) of the Glass-Steagall Act provides:

"State member banks shall be subject to the same limitations and conditions with respect to the purchasing, selling, underwriting, and holding of investment securities and stock as are applicable in the case of national banks under [§ 16]." 48 Stat. 165, 12 U. S. C. § 335.

debates leading up to the enactment of the Glass-Steagall Act, Congress focused its attention on commercial banks' participation in the markets for long-term and speculative securities, and commercial paper was distinguished from the investment securities that Congress was worried about. See S. Rep. No. 77, *supra* n. 8, at 4, 8, 9; 75 Cong. Rec. 9904, 9909, 9910, 9912 (1932).[13] Moreover, although commercial banks' purchasing activities were a major subject of congressional concern, and although commercial banks were the dominant buyers of commercial paper at the time, no one in Congress, as far as anything brought to this Court's attention shows, ever adverted to banks' commercial paper activities as contributing to the difficulties at which the Act was aimed. See App. to Pet. for Cert. 75a–76a. Thus, the legislative history shows Congress to have been concerned with commercial banks' involvement with investment instruments, as the Board contends, and not with their involvement with commercial paper.

In sum, the language of §§ 16 and 21 strongly supports the Board's interpretation. Indeed, petitioners have suggested no other construction that can be accommodated by the language of the statute. Since the legislative history makes it impossible to argue that Congress intended something contrary to the statutory language, the Board's conclusion about legislative intent concerning commercial paper appears to be compelled by statute. In any event, it is certainly "a reasonable construction of the statutory language and is consistent with legislative intent." No. 83–614, *Securities Industry Assn.* v. *Board of Governors of Federal Reserve System*, *post*, at 217.

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[13] See also Operation of the National and Federal Reserve Banking Systems: Hearings on S. 4115 before the Senate Committee on Banking and Currency, 72d Cong., 1st Sess., pt. 1, pp. 66–67, 146 (1932); Operation of the National and Federal Reserve Banking Systems: Hearings pursuant to S. Res. 71 before a Subcommittee of the Senate Committee on Banking and Currency, 71st Cong., 3d Sess., App., pt. 7, pp. 1006–1019 (1931).

II

Petitioners advance several arguments in an effort to demonstrate the error of the Board's reading of the Glass-Steagall Act, but these arguments are unavailing. It is worth noting at the outset that I have no quarrel with the Court's extensive discussion of the general policies behind the Glass-Steagall Act. *Ante*, at 144–148. None of that discussion, however, speaks to the threshold question whether commercial paper is among the "securities" to which Congress thought those policies would apply when it adopted the Act. For all of the reasons given above, the Board's negative answer to that question is all but mandated by the statutory language and is not contradicted by anything in the legislative history. The Board came to the reasonable conclusion that Congress simply had no intention to apply its policies to commercial paper.

Petitioners argue that Congress understood commercial paper to be a "security" in enacting the Securities Act of 1933, 48 Stat. 74, as amended, 15 U. S. C. § 77a *et seq.*, the Securities Exchange Act of 1934, 48 Stat. 881, as amended, 15 U. S. C. § 78a *et seq.* (containing an express exclusion of commercial paper from the definition of "security," 48 Stat. 882, as amended, 15 U. S. C. § 78c(a)(10)), and the Public Utility Holding Company Act of 1935, 49 Stat. 803, as amended, 15 U. S. C. § 79a *et seq.* They suggest that this contemporaneous congressional understanding of the scope of the term "securities" requires commercial paper to be treated as a "security" within the meaning of the Glass-Steagall Act. Even accepting its premise, however, the argument does not affect the merits of the Board's position.

In determining the meaning of a term in a particular statute, the meaning of the term in other statutes is at best only one factor to consider, and it may turn out to be utterly irrelevant in particular cases. Congress need not, and frequently does not, use the same term to mean precisely the same thing in two different statutes, even when the statutes

are enacted at about the same time. In this case, the argument from other statutes has little or no weight. Petitioners, who make this argument entirely in the abstract, offer no reason to think that Congress specifically intended "security" to have the same meaning in the Glass-Steagall Act and the securities laws, and the first part of this opinion shows that there are many reasons to think otherwise. In addition, the securities laws' definitions of "security" include some instruments that plainly do not constitute securities under the Glass-Steagall Act. For example, bankers' acceptances are securities under § 2(1) of the Securities Act of 1933, 48 Stat. 74, as amended, 15 U. S. C. § 77b(1), yet commercial banks have long bought and sold and dealt in bankers' acceptances as a proper part of their commercial banking, the Board having determined in 1934 that bankers' acceptances were not securities under the Glass-Steagall Act. See App. to Pet. for Cert. 81a.[14]

That the term "securities" should have different meanings in the different statutes makes good sense. The purposes of the banking and securities laws are quite different. The Glass-Steagall Act was designed to protect banks and their depositors. See *Board of Governors of Federal Reserve System* v. *Investment Company Institute*, 450 U. S., at 61; 75 Cong. Rec. 9913–9914 (1932) (remarks of Sen. Bulkley). The securities laws were designed more generally to protect investors and the general public. See *United Housing Foundation, Inc.* v. *Forman*, 421 U. S. 837, 849 (1975).

In response to the demonstration that the language of §§ 16 and 21 simply cannot accommodate their view without outlawing concededly lawful commercial bank activities, petitioners argue that at least some of the activities at issue are authorized by other statutory language. Most important,

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[14] The Board observed in its ruling under review in this case that similar problems might arise with respect to certificates of deposit, passbook savings accounts, loan participations, and bills of exchange. App. to Pet. for Cert. 81a–82a.

petitioners observe, national commercial banks have been authorized to purchase commercial paper on their own accounts, under their authority to discount and negotiate promissory notes, since enactment of the National Bank Act in 1864, 13 Stat. 101, currently codified in 12 U. S. C. § 24 Seventh, immediately prior to § 16 of the Glass-Steagall Act. Thus, a national bank has the power "[t]o exercise by its board of directors or duly authorized officers or agents, subject to law, all such incidental powers as shall be necessary to carry on the business of banking; by discounting and negotiating promissory notes, drafts, bills of exchange, and other evidences of debt; by receiving deposits; by buying and selling exchange, coin, and bullion; by loaning money on personal security; and by obtaining, issuing, and circulating notes according to the provisions of this chapter."

The existence of separate statutory authorizations for banking activity prohibited by petitioners' reading of the Glass-Steagall Act, however, only reinforces the Board's conclusion that "notes" and "securities" cannot have the broad meaning in §§ 16 and 21 that petitioners attribute to it. If any such statutory authorizations and the proscriptions of the Glass-Steagall Act are both to remain in force, only two conclusions are possible. Either the terms "notes" and "securities" must have a meaning narrower than the generic one; or there is a conflict of statutes that cannot be resolved by any interpretation of the statutory language, so that one part of federal banking law must be read as implicitly repealing or overriding another. The latter alternative is a last resort, however, and must be avoided where an interpretation of the statutory language is available that is consistent with legislative intent and that shows the conflict to be merely apparent and not real. As shown above, the Board's reading of §§ 16 and 21 is such an interpretation. It makes sense of the language of federal banking law: for example, it construes "notes" in § 21, in accordance with the terms that surround it in the statute, as referring to investment instruments and hence as not including commercial paper; at the same time, it

construes "promissory notes" in the "discounting and negotiating" language of the National Bank Act, in accordance with the terms that surround it in the statute, as referring to commercial banking instruments and hence as including commercial paper. Petitioners and the Court, by contrast, have not suggested any way out of the flat contradictions that their view of the Glass-Steagall Act creates in federal banking law. It was reasonable for the Board to conclude, App. to Pet. for Cert. 74a–75a, that the language of §§ 16 and 21 itself makes untenable the broad reading of "notes" and "securities" that petitioners suggest and should be read in the narrow fashion set out in the Board's opinion.

Petitioners also contend that the Board's position is shown to be erroneous by the fact that almost 50 years elapsed between the enactment of the Glass-Steagall Act and the Board's ruling. This fact, of course, does not undermine—it does not even address—the otherwise unanswered arguments in support of the Board. In any event, it is of little significance. This is not a case in which a contemporaneous agency construction is later abandoned by the agency. Until it ruled in the Bankers' Trust matter, the Board never took a position on the applicability of the Glass-Steagall Act to commercial paper. That the Board was not asked for almost 50 years to take a position on this question, moreover, simply cannot count for much. There might be any number of reasons—for example, economic reasons (comparative unattractiveness of selling commercial paper) or sociological reasons (conservativism of commercial banks)—to account for commercial banks' not having sought to sell commercial paper until the late 1970's. This Court is in no position to conclude that there simply could be no explanation for this long silence other than the clarity of the Glass-Steagall Act's prohibition, especially when neither statutory language nor legislative history supports such a conclusion.

In response to the Board's contention that the language of § 21 is reasonably construed to apply only to instruments with the characteristics of an investment, petitioners argue that

there is no single set of such characteristics that are common features of stocks, bonds, and debentures, the items listed in § 21 that the Board takes as the starting point for its interpretation. This argument, however, mistakenly places "stocks," on the one hand, and "bonds" and "debentures," on the other, into a single class. Section 16's reference to "securities and stock" establishes that the Glass-Steagall Act distinguishes two classes—"securities," which includes only (though not necessarily all) debt instruments, such as bonds and debentures; and "stock," which includes only equity instruments. The Board's interpretation of "notes" accordingly need assimilate the term only to the class that includes bonds and debentures, not the class that consists of stock, in order to justify reliance on the canon of statutory construction that words placed together should be given a related meaning. See *supra*, at 166–167. The Board's interpretation, which reads "notes" as referring to short-term debt instruments, like bonds and debentures, issued under indenture agreements, does just that.

The Court decries the Board's approach as transforming the Glass-Steagall Act from the prohibitory statute that Congress enacted into a quite different statute delegating regulatory authority over the area to the Board. To be sure, the Board takes the position that the distinguishing characteristic of the instruments covered by the Glass-Steagall Act is whether the instruments represent investment transactions rather than bank-loan transactions. An investment instrument, according to the Board, may be distinguished by reference to a cluster of related characteristics not possessed by commercial paper—for example, the absence of a short maturity, the existence of a substantial secondary market for them, their bearing of "market" risk in addition to "credit" risk, the issuer's freedom to use the proceeds for fixed capital purposes, their common availability to purchasers in small denominations, and their commonly being bought by a large number of purchasers.

There is nothing the least bit unusual about the "cluster" approach to defining a legal term or concept. That is precisely the approach taken by the law every time it gives definition to a term by specifying a set of "factors" to be considered rather than a set of necessary and sufficient conditions to be checked off. The law is replete with instances of this approach, made necessary by the intrinsic complexity and untidiness of our legal concepts and of the world to which they are designed to apply. This approach is hardly out of place in the law's attempt to describe and regulate the financial world, with all its intricacies and its bewildering variety of nominally different but substantively similar (if not identical) financial instruments and transactions.

There is simply no escaping some kind of functional analysis to separate the commercial and investment banking worlds in particular cases, which petitioners acknowledge is at least one chief aim of the Glass-Steagall Act. As noted above, see *supra*, at 165–169, the language of §§ 16 and 21 cannot be read in the sweeping fashion suggested by petitioners: otherwise, those provisions would prohibit concededly permitted commercial bank involvement with a variety of instruments such as commercial paper. Petitioners have suggested no way to make the distinctions needed to give sense to the statutory language that does not involve a functional analysis of what constitutes investment banking and what constitutes commercial banking. For example, petitioners have suggested no way to distinguish the "discounting and negotiating" of "promissory notes," permitted by the National Bank Act, from the "purchasing" of "notes," prohibited by §§ 16 and 21 of the Glass-Steagall Act, a distinction that their position requires them to make. It is hard to imagine how that distinction might be drawn without using a "functional" approach to defining the difference between the commercial and investment banking worlds.

Finally, contrary to petitioners' allegation, the Board's functional analysis does not vest the Board with a substantial

amount of regulatory discretion. In particular, it does not permit the Board to make case-by-case judgments about the Glass-Steagall Act's application to a particular instrument based on the instrument's safety and on whether it presents the dangers addressed by the Act. Indeed, the Board specifically declined to conduct a policy analysis of whether certain commercial paper activities presented the dangers at which the Act was aimed. See App. to Pet. for Cert. 83a. The Board, unlike the Court of Appeals, concluded that the Glass-Steagall Act is inapplicable to all commercial paper, not just to the particular kinds of commercial paper sold by Bankers Trust, *ibid.* The Board's conclusion about the meaning of the Glass-Steagall Act was simply a construction of the statute; it was only under distinct statutory authority to restrain unsafe or unsound banking practices, 38 Stat. 259, 261, as amended, 12 U. S. C. §§248 and 321; 64 Stat. 879, as amended, 12 U. S. C. §1818(b), that the Board issued its guidelines specifying the kinds of commercial paper sales by commercial banks that it would permit.

The Board employed its functional analysis as one small part of its inquiry into the best construction of the statute. The Board did not purport in its ruling to lay down rules for determining what other instruments have the characteristics of an investment instrument so as to constitute a "security" under the Glass-Steagall Act. It simply reasoned that the language and history of the Act demonstrated that the Act does not cover commercial paper. Critical to the Board's conclusion is the fact that federal banking law treats commercial paper in such a way as to give rise to a flat contradiction if the Glass-Steagall Act were interpreted to embrace it. Because of its characteristics, commercial paper has long been treated, by federal law and by bankers, not as an investment instrument but as an instrument that commercial banks may purchase without regard to the proscriptions of the Glass-Steagall Act. Thus, the Board's placing of commercial paper in the commercial rather than investment banking

world is firmly rooted in the statutory language and in a long-standing practice whose lawfulness is not even subject to dispute. Nothing in the Board's ruling extends to any instrument not already widely and lawfully purchased by commercial banks, and petitioners have not identified any class of financial instruments other than commercial paper that would come within the Board's reasoning in this case. The Board's ruling, in other words, is a narrow one with few implications for other applications of the Glass-Steagall Act.

III

The dangers that Congress sought to eliminate when it enacted the Glass-Steagall Act are easily stated at a level of generality that might make the Board's ruling appear inconsistent with congressional policies. The translation of policy into legislation, however, is always complicated by the necessity of taking into account potentially competing and overlapping laws and policies. The task of this Court, therefore, is to interpret the statutory language that Congress enacted into law. Careful attention to the statutory language is especially important in an area as technical and complex as banking law, where the policies actually enacted into law are likely to be complicated and difficult for a nonspecialist judiciary to discern in their proper perspective.

In this case, the statutory language strongly supports the construction adopted by the Board, and it cannot bear the only construction proposed by petitioners and adopted by the Court. The Board's construction is also wholly consistent with the legislative history. It is singularly inappropriate for this Court, reasoning from the general policies it finds in the statute and with little regard for the statutory language, to reject the construction of the statute adopted by the Board after careful consideration and with full explanation. It is the Board, and not this Court, that has both responsibility for the oversight of much of our Nation's banking system and expertise and experience in applying the arcane body of law

that governs it. When the statutory support for the Board's position is as strong as it is in this case, the Court's rejection of the agency's position is unjustified.

I would uphold the Board's ruling that commercial paper does not constitute a "security" within the meaning of the Glass-Steagall Act. Because the Court of Appeals' opinion does not squarely uphold the Board's statutory construction, I would affirm only the judgment of the Court of Appeals, which reverses the District Court's judgment declaring the Board's ruling unlawful.

I respectfully dissent.

Opinion of the Court of Appeals, November 2, 1982

UNITED STATES COURT OF APPEALS
DISTRICT OF COLUMBIA CIRCUIT

Nos. 80-2258, 81-2070, 81-1493, 81-2058, 81-2096 and 80-2314

Argued 3 June 1982
Decided 2 Nov. 1982
As Amended Nov. 2, 1982

A.G. BECKER INCORPORATED,
Petitioner-Appellee,

—v.—

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, et al.,
Respondents-Appellants.

SECURITIES INDUSTRY ASSOCIATION,
Petitioner-Appellee,

—v.—

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, et al.,
Respondents-Appellants.

APPEARANCES:

Richard M. Ashton, Washington, D.C., with whom Michael Bradfield, Washington, D.C., was on the brief for Bd. of Governors of the Federal Reserve System, et al., appellants Nos. 81-2058 and 81-2070 and appellants/respondents in Nos. 80-2258, 80-2314, 81-1493 and 81-2096, James V. Mattingly, Jr., Washington, D.C., also entered an appearance for the Bd. of Governors of the Federal Reserve System, et al.

James B. Weidner, New York City, with whom John M. Liftin, Washington, D.C., was on the brief for Securities Industry Ass'n., petitioner in No. 80-2314 and appellee in No. 81-2058. Janet R. Zimmer, Washington, D.C., also entered an appearance for Securities Industry Ass'n.

Harvey L. Pitt, Washington, D.C., with whom Henry A. Hubschman and Andrea Newmark, Washington, D.C., were on the brief for A.G. Becker Inc., petitioner in No. 80-2258, appellants in Nos. 81-2096 and 81-1493 and appellee/respondent in No. 80-2070. James H. Schropp, Washington, D.C., also entered an appearance for A.G. Becker Incorporated.

Robert S. Rifkind, New York City, entered an appearance for New York Clearing House Ass'n, amicus curiae in Nos. 81-1493, 81-2258 and 81-2096.

Charles F.C. Ruff, U.S. Atty., Royce C. Lamberth, Kenneth M. Raisler, William H. Briggs, Jr., Asst. U.S. Attys., Washington, D.C., also entered an appearance for appellee/respondent in No. 81-1493.

John W. Barnum and W. Michael Tupman, Washington, D.C., entered appearances for Bankers Trust Co., amicus curiae in Nos. 80-2314, 81-2058, 80-2258, 81-1493, 81-2096 and 81-2070.

Leonard H. Becker, Steven A. Musher and Joseph McLaughlin, Washington, D.C., entered appearances for Goldman, Sachs and Co., amicus curiae in Nos. 80-2314, 81-2058, 80-2258, 81-1493, 81-2096 and 81-2070.

Paul Gorson and Russell Stevenson, Washington, D.C., entered appearances for Securities and Exchange Com'n, amicus curiae in Nos. 81-2096 and 81-2058.

Before TAMM and WILKEY, Circuit Judges and ROBB, Senior Circuit Judge.

Opinion for the Court filed by Circuit Judge WILKEY.

Dissenting opinion filed by Senior Circuit Judge ROBB.

WILKEY, *Circuit Judge*:

This case calls upon us to decide whether the Federal Reserve Board acted lawfully in permitting the Bankers Trust Company, a state member bank of the Federal Reserve System,[1] to act as agent in the sale of commercial paper. After Bankers Trust began marketing commercial paper, A.G. Becker, Inc., a broker-dealer in securities, and the Securities Industry Association ("SIA"), an organization representing over five hundred securities brokers and dealers, requested the Board to declare Bankers Trust's activities illegal and to bring appropriate enforcement action. Becker and the SIA contended that Bankers Trust was in violation of sections 16 and 21 of the Glass-Steagall Act ("the Act"), which prohibit commercial banks, with certain exceptions, from buying, selling, or underwriting "securities."[2] The Federal Reserve Board determined, however, that the commercial paper marketed by Bankers Trust

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1 *See* 12 U.S.C. §§ 321-339 (1976 & Supp. IV 1980).

2 Section 16 of the Act provides in pertinent part:

> The business of dealing in securities and stock by the association shall be limited to purchasing and selling such securities and stock without recourse, solely upon the order, and for the account of, customers, and in no case for its own account, and the association shall not underwrite any issue of securities or stock; *Provided*, That the association may purchase for its own account investment securities under such limitations and restrictions as the Comptroller of the Currency may by regulation prescribe.

12 U.S.C. § 24 Seventh (Supp. IV 1980).

Section 21 provides that:

> [I]t shall be unlawful . . . [f]or any person, firm, corporation, association, business trust, or other similar organization, engaged in the business of issuing, underwriting, selling, or distributing, at wholesale or retail, or through syndicate participation, stocks, bonds, debentures, notes, or other securities, to engage at the same time to any extent whatever in the business of receiving deposits subject to check or to repayment upon presentation of a passbook, certificate of deposit, or other evidence of debt, or upon request of the depositor. . . .

12 U.S.C. § 378(a)(1)(1976).

was not a "security" within the meaning of the Act.[3] Becker and the SIA then brought suit in the district court, which held the Board's determination to be invalid.[4] The Board appealed, and we reverse.

I. FACTS

"Commercial paper" refers to prime quality, negotiable promissory notes bearing very short maturities—generally 30 to 90 days.[5] Large, financially strong corporations use commercial paper to obtain funds for current needs. Commercial paper is sold, in denominations averaging one million dollars or more, to large, sophisticated purchasers—money market mutual funds, bank trust departments, insurance companies and pension funds.[6]

Bankers Trust began placing third party commercial paper in 1978.[7] Its issuers had the highest rating from at least one of the rating services for commercial paper issuers; its customers were part of the bank's established base of institutional investors, who regularly purchase short term instruments from the bank. The bank offered to act as financial adviser to issuers of paper sold by the bank, and to extend credit to them, though for only

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3 Federal Reserve System, Statement Regarding Petitions to Initiate Enforcement Action (26 Sept. 1980), Joint Appendix (J.A.) at 220 [hereinafter cited as Federal Reserve Statement].

4 *A.G. Becker, Inc.* v. *Board of Governors*, 519 F. Supp. 602 (D.D.C. 1981).

5 *See generally* Hurley, *The Commercial Paper Market*, 63 Fed. Res. Bull. 525 (1977); Comment, *The Commercial Paper Market and the Securities Acts*, 39 U. Chi. L. Rev. 362 (1972).

6 *See* sources cited at *supra* note 5. *See also infra* p. 149 [26a].

7 This description of Bankers Trust's activities relies upon Federal Reserve Statement, *supra* note 3, at 2-3, J.A. at 221-22. Appellees do not challenge the Board's factual findings as to Bankers Trust's participation in the commercial paper market.

a small portion of the unsold amount of the issue. It did not commit itself to purchase unsold paper, but it did purchase in the secondary market commercial paper of issuers for which it had acted. Bankers Trust was the first commercial bank to enter the commercial paper market in competition with the investment banks; other commercial banks awaited the outcome of subsequent legal proceedings.

Becker and the SIA requested the staff of the Federal Reserve Board to review the legality of Bankers Trust's activities. The Board's general counsel, after extensive discussion with Becker, SIA, Bankers Trust and the SEC, issued an opinion declaring that commercial banks may lawfully act as agent for the issuer in the sale of commercial paper, "provided that the sales . . . are limited to purchasers to whom commercial banks normally sell participations in loans."[8] Becker and the SIA then requested the Federal Reserve Board to review the decision of its general counsel and to proscribe the commercial paper activities of member banks. After considering submissions by interested parties and conducting an on-site investigation of Bankers Trust's activities, the Board ruled that Bankers Trust's participation in the commercial paper market did not violate the Glass-Steagall Act or contravene public policy.[9]

In a carefully reasoned opinion the Board first concluded that there was no indication in the language or legislative history of the Glass-Steagall Act that Congress considered commercial paper to be a "security," in which banks were forbidden to deal.[10] The Board noted that banks had traditionally traded in commercial paper, and that the Act had been intended to strengthen banks in the exercise of traditional banking functions. The Board then turned to a "functional" analysis of the statutory terms, and concluded that, because

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8 Legal Division, Board of Governors of the Federal Reserve System, Commercial Paper Activities of Commercial Banks: A Legal Analysis 21 (28 June 1979), J.A. at 168.

9 Federal Reserve Statement, *supra* note 3.

10 *Id.* at 6-17, J.A. at 225-36.

commercial paper embodies short-term loans from a few sophisticated lenders to financially strong borrowers, it resembled a loan rather than a security for the purpose of the Glass-Steagall Act.[11] Because the Board ruled that commercial paper was not a "security," it did not reach the issue whether Bankers Trust was "issuing, underwriting, selling, or distributing" securities within the meaning of the Glass-Steagall Act.[12]

Subsequently, the Board issued guidelines to ensure that sale of third party commercial paper did not give rise to "unsafe or unsound practices."[13] These guidelines permitted banks to sell only prime quality third party commercial paper with maturity of nine months or less and in denominations of over $100,000. Banks could sell only to "financially sophisticated customers," and were forbidden to advertise to the general public. Sales to the bank's fiduciary accounts, parent holding companies and nonbank affiliates were also forbidden. Moreover, banks were required to maintain credit analyses of issuers, to limit the amount of paper sold for any issuer, and to maintain detailed records of sales, purchases and lines of credit extended. Finally, various disclosure requirements were imposed.

SIA and Becker sought review in the district court of the Board's ruling that commercial paper was not a "security." That court concluded that the Act's "plain language" barred commercial banks from trading in commercial paper.[14] It also found that the "broad framework" of the Act evinced Con-

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11 *Id.* at 17-20, J.A. at 236-39. The Board also rejected the arguments that the definition of "security" in the Securities Act of 1933, or considerations of public policy, militated against permitting Bankers Trust's sale of third party commercial paper. *Id.* at 20-27, J.A. at 239-46.

12 *Id.* at 24, J.A. at 243.

13 Policy Statement Concerning the Sale of Third Party Commercial Paper by State Member Banks, 46 Fed. Reg. 29333, 29334-35 (26 May 1981) [hereinafter cited as Guidelines].

14 *Becker*, 519 F. Supp. at 612-13.

gress' intent to institute a sweeping prohibition of commercial banks' engaging in investment banking activities.[15] Finally, in response to the Board's "functional" analysis of commercial paper, the court averred that "[o]ne factor . . . compels the conclusion that the commercial paper at issue here is [a security], and that crucial aspect is the role of Bankers Trust in the transaction."[16] For these reasons, the district court issued a declaratory judgment that the Board's ruling was contrary to law.[17]

We reverse. The district court gave insufficient weight to the expertise of the Federal Reserve Board—as the agency responsible for administering the nation's banking system—in interpreting the provisions of the Glass-Steagall Act. Moreover, the language of the Act, its legislative history and the policies underlying it all support the Board's conclusions that commercial paper is not a "security" under the Act. We discuss each of these findings in turn.

II. STANDARD OF REVIEW

The Supreme Court recently had occasion again to delineate the standard to be applied in the review of an agency's interpretation of a statute which it is charged to implement.

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15 *Id.* at 614-15.

16 *Id.* at 615-16.

17 *Id.* at 616. The district court confined its holding to the question of whether the commercial paper at issue was a "security." Like the Board, it did not reach the question whether Bankers Trust was "underwriting" securities in violation of the Glass-Steagall Act. *See id.* at 616 n. 10.

Moreover, the district court did not explicitly rule on the validity of the Board's guidelines. However, because the guidelines in essence describe Bankers Trust's activities, it would be difficult to reconcile those guidelines with the district court's holdings. Conversely, if we find that Bankers Trust has acted lawfully, the activities of other commercial banks in compliance with the guidelines would be lawful as well. *See* Part IV (Conclusion) *infra*.

The task of the reviewing court is "not to interpret the statute as it [thinks] best but rather the narrower inquiry into whether the [agency's] construction was '*sufficiently reasonable*' to be accepted by a reviewing court. . . . To satisfy this standard it is not necessary for a court to find that the agency's construction was the only reasonable one or even the reading the court would have reached if the question initially had arisen in a judicial proceeding."[18]

In particular, the Board's ruling in the present case warrants deference for a number of reasons. First, the Board is "the type of agency to which deference should presumptively be afforded" because of *the scope of its authority.* Congress has vested the Board with "primary and substantial responsibility for administering" federal regulation of the national banking system.[19] The Board exercises "general supervisory" powers over member banks,[20] and is responsible to bring enforcement actions to prevent member banks from engaging in "unsafe or unsound" banking practices.[21] The Board thus formulates national banking policy, and, in implementing this policy, exercises broad rulemaking and adjudicative powers.

Second, deference to the Board's conclusions is warranted by its *expert knowledge of commercial banking*. "Not only because Congress has committed the [Federal Reserve] [S]ystem's operation to [the Board's] hands, but also because the system itself is a highly specialized and technical one, requiring expert and coordinated management in all of its phases, . . . their judgment should be conclusive upon any

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18 *Fed. Election Comm'n* v. *Democratic Senatorial Campaign Comm.*, 454 U.S. 27, 39, 102 S.Ct. 38, 46, 70 L.Ed.2d 23 (1981) (emphasis added) (citations omitted).

19 *Compare Democratic Senatorial Campaign Comm.*, 454 U.S. at 39, 102 S.Ct. at 46.

20 *See* 12 U.S.C. § 248 (1976).

21 *See* 12 U.S.C. § 1818(b) (Supp. IV 1980). *See also* 12 U.S.C. § 501a (1976) (enforcement actions for violation of banking laws and regulations).

matter which . . . is open to reasonable difference of opinion. Their specialized experience gives them an advantage judges cannot possibly have . . . in ascertaining the meaning Congress had in mind in prescribing the standards by which they should administer [the system]."[22]

Third, deference to an agency's construction of the statute is called for because *the agency's decision applies general, undefined statutory terms*—"notes and securities"—to particular facts. While the Glass-Steagall Act contains a sweeping prohibition of commercial banks' trading in "securities," that term is, of course, not self-defining.[23] Moreover, we cannot assume that Congress intended the term to comprise a set of rigid and unchanging categories. Rather, such statutory drafting "leave[s] the agency with the task of evolving definitions on a case-by-case basis."[24] The regulatory structure of the banking laws must be permitted to adapt to the changing financial needs of our economy.[25] Congress has delegated to the Federal Reserve Board, rather than to this court, the complex task of applying the Act's general proscriptions to current business reality. We must therefore defer to the Board's interpretation of the statute if that interpretation is reasonable.

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22 *Board of Governors of the Federal Reserve System* v. *Agnew*, 329 U.S. 441, 450, 67 S.Ct. 411, 415, 91 L.Ed. 408 (1947) (Rutledge, J. concurring). *See Board of Governors of Federal Reserve System* v. *Investment Co. Inst.*, 450 U.S. 46, 56 n.21, 101 S.Ct. 973, 981 n.21, 67 L.Ed.2d 36 (1981) (citing *Agnew*) [hereinafter cited as *ICI II*].

23 *See infra* p. 143 [13a-16a].

24 *Puerto Rico* v. *Blumenthal*, 642 F.2d 622, 635 (D.C. Cir. 1980), *cert. denied*, 451 U.S. 983, 101 S.Ct. 2315, 68 L.Ed.2d 840 (1981); *Chisholm* v. *FCC*, 538 F.2d 349, 358 (D.C. Cir.), *cert. denied*, 429 U.S. 890, 97 S.Ct. 247, 50 L.Ed.2d 173 (1976).

25 *Cf. M & M Leasing Corp.* v. *Seattle First Nat'l Bank*, 563 F.2d 1377, 1382 (9th Cir. 1977), *cert. denied*, 436 U.S. 956, 98 S.Ct. 3069, 57 L.Ed.2d 1121 (1978) (bank laws construed to permit "use of new ways of conducting the very old business of banking"). The current situation of the commercial paper market could not have been foreseen by Congress at the time the Glass-Steagall Act was passed: that market has changed drastically since the Depression. *See infra* note 85.

Finally, "*the thoroughness evident in the consideration* [of an agency's interpretation of a statute], *the validity of its reasoning*, [and] *its consistency with earlier and later pronouncements*" are factors that bear upon the amount of deference to be given to an agency's ruling.[26] In this instance, the agency's interpretation of the statute is based on a thorough and expert review of the relevant legal and policy considerations as well as of the facts of this case. The Board conducted an extensive inquiry into the operation of Bankers Trust commercial paper operations and the function of the commercial paper market; it clearly set forth its findings, conclusions, and bases for its reasoning.[27] And the Board's conclusion is consistent with prior decisions, including some roughly contemporaneous with the passage of the Glass-Steagall Act.[28]

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26 *Skidmore* v. *Swift & Co.*, 323 U.S. 134, 140, 65 S.Ct. 161, 164, 89 L.Ed. 124 (1944) (emphasis added). *See Democratic Senatorial Campaign Comm.*, 454 U.S. at 39, 102 S.Ct. at 46 (citing *Swift*); *Adamo Wrecking Co.* v. *United States*, 434 U.S. 275, 287 n.5, 98 S.Ct. 566, 574 n.5, 54 L.Ed.2d 538 (1978) (same).

27 Federal Reserve Statement, *supra* note 3.

28 For example, in 1933 the Board stated that commercial paper, defined as short-term paper issued for obtaining funds for current transactions and purchased by banks and corporations with temporarily idle funds, should not be considered an investment security. *See Federal Securities Act: Hearing on H.R. 4314 before the House Comm. on Interstate and Foreign Commerce*, 73d Cong., 1st Sess. 180-81 (1933); *Securities Act: Hearings on S. 875 Before the Senate Comm. on Banking and Currency*, 73d Cong., 1st Sess. 120 (1933); Federal Reserve Statement, *supra* note 3, at 11, J.A. at 230.

The assumption that commercial paper is a loan rather than a security pervades current banking regulation. The Board has ruled that issuance of commercial paper by a bank holding company does not fall within section 20 of the Glass-Steagall Act, the analogous provision for those companies. *See* 12 C.F.R. § 250.221(e)(1982). Under the rules of the Comptroller General's office, commercial paper holdings by banks are subject to the statutory limits on loans rather than investment securities. *See* 12 C.F.R. § 7.1180 (1982) (interpreting 12 U.S.C. § 84 (1976)); Federal Reserve Statement, *supra* note 3, at 11-12, J.A. at

For these reasons, which we have considered in prior opinions and which may frequently be found of use in evaluating administrative agency decisions, we should hesitate to overturn the Board's decision as long as that decision is a reasonable interpretation of the Glass-Steagall Act. And, as will appear below, the decision was reasonable. We do not, however, rest merely on the deference to the conclusions of the Federal Reserve Board. "[T]o accord deference is not to abdicate our duty to construe the statute, for 'the courts are the final authorities and are not obliged to stand aside and rubber-stamp their affirmance of administrative decisions that they deem inconsistent with a statutory mandate or that frustrate the congressional policy underlying a statute.' "[29] We therefore turn to an analysis of the application of the Glass-Steagall Act to the present case.

III. APPLICATION OF THE GLASS-STEAGALL ACT

Taking account of appropriate deference to the Board's expertise and administrative responsibility, we find that its ruling and the reasoning which supports it are essentially correct. An inquiry into the language and legislative history of the statute, and the policies underlying it, supports the Board's conclusion that the commercial paper marketed by Bankers Trust is not a "security" within the Glass-Steagall Act.

A. *Background*

Congress passed the Glass-Steagall Act in 1933, in response to what it perceived to be the abuses which resulted from the involvement of commercial banks in securities underwriting. Congress considered that commercial banks, by underwriting

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230-31. And commercial paper is treated as a loan for bank call reports and bank examination by the Federal Reserve Board. *Id.*

29 *Nat'l Ass'n of Recycling Inds., Inc.* v. *ICC*, 660 F.2d 795, 799 (D.C.Cir. 1981) (citations omitted).

stocks, had fueled the rampant speculation that preceded the Great Depression. Congress' principal concern in amending the banking laws, however, was to protect the solvency and integrity of the banks themselves.[30]

Stock underwriting by commercial banks undermined bank solvency in a number of ways. Most directly, commercial banks that engaged in underwriting tied up depositors' funds in the purchase of unsound or speculative securities. These investments placed commercial deposits at risk.[31] The promotional pressures exerted by underwriting activities also threatened bank solvency. To augment their commissions from securities sales, commercial banks used their credit facilities to lend to purchasers of securities.[32] Banks were also tempted to make unsound loans to client-issuers, because these loans might improve the balance sheet of these enterprises and thereby make their securities more marketable. When speculative ventures failed, these loans to purchasers and issuers were often not repaid, undermining bank solvency and depositor confidence in the banks.[33]

In addition to inducing commercial banks to purchase unsound securities and to make unsound loans, banks' participation in the securities market had more indirect effects on bank solvency. Banks' association with speculative securities ventures undermine the confidence of bank depositors in the stability of the banks.[34] Moreover, banks which underwrote

30 *Senate Comm. on Banking and Currency, Operation of the National and Federal Reserve Banking Systems*, S. Rep. No. 77, 73d Cong., 1st Sess. 2-4, 6-13 (1933).

31 *Id.* at 9-10.

32 *See* 75 Cong. Rec. 9912 (1932) (remarks of Sen. Bulkley); *Operation of the National and Federal Reserve Banking Systems: Hearings Pursuant to S.Res. 71 before a Subcomm. of the Senate Comm. on Banking and Currency*, 71st Cong., 3d Sess. 87 (1931) (remarks of Chairman Glass) [hereinafter cited as *Hearings*].

33 75 Cong. Rec. 9912 (1932) (remarks of Sen. Bulkley).

34 *Id.*

stock issues could not be relied upon to give prudent and disinterested investment advice to their depositors, for they naturally had an incentive to urge depositors to purchase shares of the issues the bank was underwriting.[35] Finally, these banks would also "dump" excess issues of unmarketable securities on their own trust departments.[36]

Congress passed the Glass-Steagall Act to correct these abuses. The Act is a prophylactic measure designed to prevent commercial banks from being exposed to the dangers which inevitably followed upon their participation in investment banking. "Congress acted to keep commercial banks out of the investment banking business largely because it believed that the promotional incentives of investment banking and the investment banker's pecuniary stake in the success of particular investment opportunities was destructive of prudent and disinterested commercial banking and of public confidence in the commercial banking system."[37]

B. *Statutory language*

Congress accomplished the separation of commercial and investment banking in sections 16 and 21 of the Glass-Steagall Act. We first ask whether the language of these sections clearly evinces a congressional determination to prohibit the activities in which Bankers Trust has engaged; if so, our inquiry necessarily comes to an end.[38]

Section 16 provides that a bank "shall not underwrite any issue of *securities or stock*" and shall not "purchase . . . for its own account . . . any *shares of stock* of any corpora-

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35 *Hearings, supra* note 32, at 237.

36 *Id.*

37 *Investment Co. Inst.* v. *Camp*, 401 U.S. 617, 634, 91 S.Ct. 1091, 1100, 28 L.Ed.2d 367 (1971) [hereinafter cited as *ICI I*].

38 *E.g.*, *Transamerica Mortgage Advisers, Inc.* v. *Lewis*, 444 U.S. 11, 16, 100 S.Ct. 242, 245, 62 L.Ed.2d 146 (1979).

tion."[39] We can find nothing in the language of this section that explicitly articulates a congressional intent to bar commercial banks from trading in commercial paper. The terms "securities" and "stock" are not defined by the Act; section 16 in no way refers explicitly to notes, the generic financial term which Congress might have used to encompass commercial paper.[40] Indeed, banks are authorized to "discount and negotiate promissory notes, drafts, bills of exchange, and other evidences of debt. . . ."[41] It is clear, then, that section 16 does not prohibit banks from selling or underwriting *all* notes, but *only* "securities or stock"; and the section does not indicate whether the commercial paper at issue in this case is included within that statutory prohibition.

We turn then to section 21 of the Act, which forbids banks from underwriting "stocks, bonds, debentures, notes, or other securities. . . ."[42] Although this statutory provision explicitly refers to "notes," that term is susceptible of at least two interpretations. First, it may refer to a specific type of long-term debt security, one that closely resembles a bond or debenture but is of shorter maturity.[43] A note in this sense, like a bond or a debenture, is issued under an indenture agreement to raise money available for an extended period of time as part of the corporation's capital structure. An investment note

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39 12 U.S.C. § 24 Seventh (Supp. IV 1980) (emphasis added). The Act allows for several exceptions; the one pertinent here is that for "investment securities." *See infra* pp. 145-146 [19a].

40 *See infra* p. 143 [15a] & note 44.

41 12 U.S.C. § 24 Seventh (Supp. IV 1980).

42 12 U.S.C. § 378(a)(1) (1976). If the language of *either* section 16 *or* section 21 must be interpreted to prohibit Bankers Trust's marketing of commercial paper, that interpretation of course governs. *See generally ICI II*, *supra*, note 22, 450 U.S. at 62-65, 101 S.Ct. at 984-86.

43 *See, e.g.*, 1 A. Dewing, The Financial Policy of Corporations 180 (4th ed. 1941); G. Munn, Encyclopedia of Banking and Finance 132 (7th ed. 1973).

differs from these other instruments in that it matures more quickly—in a few, rather than twenty or more, years.

Second, the term "notes" is sometimes used generically to refer to *any* promissory instrument regardless of maturity or negotiability.[44] In this sense, commercial paper may also be referred to as a promissory "note." Such a note differs sharply from an investment "note": commercial paper is used to obtain short-term credit for current transactions, rather than capital funds for long-term projects. Its maturity generally ranges from one to two months, and rarely exceeds nine months.[45]

The language of section 21 suggests that Congress intended only to prohibit the marketing of investment notes—*i.e.*, that it intended to use "notes" in its more specific meaning. Each of the terms listed by Congress—"stocks," "bonds," "debentures" and "notes"—refers to a specific type of long-term investment security.[46] In contrast, "notes" in the more general sense would also include financial instruments, such as commercial paper, which have little in common with these long-term investment securities.[47] Moreover, "notes" used in its

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44 *See, e.g.*, G. Munn, *supra*, note 37, at 698 (defining "note" as a "written promise . . . to pay a certain sum of money to the . . . payee").

45 *See also infra* p. 149 [26a] & note 80.

46 "Stocks," of course, represent ownership interests in a corporation. "Bonds" are secured debt instruments, issued under a trust indenture agreement, that bear long-term maturities and are offered to the public in small denominations. "Debentures" differ from bonds only in that they are unsecured.

47 *See Third Nat'l Bank in Nashville* v. *IMPAC, Ltd.*, 432 U.S. 312, 322 & n. 16, 97 S.Ct. 2307, 2313 & n. 16, 53 L.Ed.2d 368 (1977) ("words grouped in a list should be given related meanings"); *Am. Maritime Ass'n* v. *Stans*, 485 F.2d 765, 768 (D.C.Cir. 1973) (same). *Cf. Jarecki* v. *G.D. Searle & Co.*, 367 U.S. 303, 307, 81 S.Ct. 1579, 1582, 6 L.Ed.2d 859 (1961) (statutory term "gathers meaning from the words around it").

Similarly, under the familiar principle that where general words follow specific words in an enumeration, the general words are

more general sense would include debt instruments such as bonds and debentures; the explicit statutory reference to the latter would then be redundant.[48] For these reasons, specific inclusion of the terms "stocks," "bonds," and "debentures" suggests that the narrower meaning of the term "notes" was intended. We conclude that the context in which the term "notes" is used strongly implies Congress' intent not to include commercial paper within the sweep of the Act's prohibition.

Both section 16 and section 21 thus demarcate a fundamental division between notes which represent commercial banking

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construed to embrace only items similar to those specifically enumerated, *see, e.g., Harrison* v. *PPG Inds., Inc.*, 446 U.S. 578, 588, 100 S.Ct. 1889, 1895, 64 L.Ed.2d 525 (1980), the phrase "or other securities would include *only* financial instruments with the economic characteristics of those listed, *see supra* note 46, *not* commercial paper.

The conclusion that commercial paper differs markedly from those instruments which Congress intended to prohibit commercial banks from underwriting depends ultimately upon an analysis of the relevant economic characteristics of these instruments, such as the characteristics noted in text. It is clear that commercial paper differs from the family of specific instruments listed in section 21 of the Act; we explain below the relevance of these differences to the policies wich Congress intended the Act to advance. *See infra* parts IIIC (legislative history) and IIIE (functional analysis of the commercial paper market).

48 *See Ass'n of Am. R.Rs.* v. *United States*, 603 F.2d 953, 964 (D.C. Cir. 1979) (presumption that "Congress [does] not employ superfluous language").

A third reason to reject a broad definition of the term "note" is that this definition would include a number of instruments in which banks have traditionally traded—for example, certificates of deposit, notes evidencing a mortgage and notes representing commercial loans in connection with a loan syndication. All of these clearly involve a "written promise to pay a certain sum to the payee," *see supra* note 44; their sale by banks would therefore be prohibited by appellees' reading of the statute. Moreover, it makes little sense to argue, as do appellees, that we may escape this quandary by interpreting the Glass-Steagall Act to prohibit only banking practices not otherwise authorized by the banking laws: The banks may only exercise expressly granted powers in any event. *See, e.g., Arnold Tours, Inc.* v. *Camp*, 472 F.2d 427 (1st Cir. 1972); *Saxon* v. *Georgia Ass'n of Indep. Ins. Agents, Inc.*, 399 F.2d 1010 (5th Cir. 1968).

transactions—transactions which are, of course, permitted under the Act—and securities, such as investment notes, which commercial banks are prohibited from underwriting. Section 16 indicates this distinction by authorizing commercial banks to negotiate "promissory notes," while forbidding banks to negotiate "securities or stocks." Section 21 makes the distinction by barring banks from trading in specified instruments for raising capital as part of the permanent financial structure of a corporation—stocks, bonds, debentures and notes—while implicitly permitting transactions in other types of debt instruments. And the language of these sections, while not conclusive, strongly suggests that sale of commercial paper should be treated as a "loan" rather than a sale of securities for the purposes of the Act.

C. *Legislative history*

The distinction between commercial loans and securities emerges as well from an analysis of the legislative history. Throughout its debates on the causes of the imperiled state of the banking industry, Congress nowhere considered the banks' activity in the commercial paper market as contributing to their difficulties.[49] The commercial paper market was simply not part of the problem to which the Glass-Steagall Act was addressed.[50] Rather, Congress focused its attention on the commercial banks' participation in "speculative" securities markets: their extensive underwriting of long-term holdings of high risk stocks and bonds.

For example, the Senate Report on the Act notes that "[t]he outstanding development in the commercial banking system during the prepanic period was the appearance of excessive

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49 *See* Federal Reserve Statement, *supra* note 3, at 14-15, J.A. at 233-34.

50 This is particularly remarkable because, at the time the Glass-Steagall Act was passed, almost all commercial paper issued was purchased by commercial banks for their own account. *See* Hurley, *supra* note 5.

security loans, and of over-investment in securities. . . . [A] very fruitful cause of bank failures . . . has been the fact that the funds of various institutions have been so extensively '*tied up' in long-term investments*."[51] Congress condemned "the excessive use of bank credit in making loans for the purpose of *stock speculation*. . . ."[52] In short, the purpose of the Act was to reverse "a loose banking policy which had turned from the making of loans on *commercial paper* to the making of loans on *security*."[53]

The distinction between bank participation in the securities and in the commercial paper markets is also illustrated in Congress' treatment of section 2(b) of the McFadden Act.[54] Section 2(b) limited the amounts of "investment securities" national banks could hold.[55] It is clear, however, that *commercial paper was not considered an "investment security"* under the McFadden Act: banks were left free to trade in commercial

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51 S. Rep. No. 77, *supra* note 30, at 8 (emphasis added).

52 *Id.* at 9 (emphasis added).

53 *Id.* at 4 (emphasis added). The hearings and floor debates of the Act are also replete with evidence that Congress was concerned with banks' speculation in long-term equity and debt securities rather than with their participation in the commercial paper market. *See, e.g.*, 77 Cong. Rec. 3725, 3837 (1933) (remarks of Sen. Glass); *Hearings, supra* note 32, at 1006-19; *Operation of the National and Federal Reserve Banking Systems; Hearings on S. 4115 Before the Senate Comm. on Banking and Currency*; 72d Cong., 1st Sess. 146 (1932) (remarks of Sen. Glass); *id.* at 66-67 (remarks of president of American Bankers Association); 75 Cong. Rec. 9904 (1932) (remarks of Sen. Walcott); *id.* at 9911-12 (remarks of Sen. Bulkley) (promotional pressures encouraging over-development of collateral-security loans and over-production of capital securities).

54 Ch. 191, 44 Stat. 1224 (1927).

55 44 Stat. at 1226 (codified at 12 U.S.C. § 24 Seventh (Supp. IV 1980)). The Act restricted bank holdings of the securities of any one obligor to twenty-five percent of the bank's holdings. *Id.* The Glass-Steagall Act further restricted the permissible amounts of these holdings. Ch. 89, sec. 16, 53 Stat. 162, 185 (1933) (later modified).

paper without restriction.[56] It is significant, therefore, that Congress preserved the provisions of the McFadden Act when it passed the Glass-Steagall Act six years later.[57] The legislative history of the Glass-Steagall Act provides no indication that Congress intended to change the McFadden Act's definition of "investment security."[58] Moreover, it is unlikely that Congress would consider commercial paper to be a "security" but *not* an "investment security."[59] Thus, Congress' incorporation of the McFadden Act into the revised banking laws, like other aspects of the legislative history, indicates an intent to continue to leave banks free to deal in commercial paper.

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56 Federal Reserve Statement, *supra* note 3, at 9, J.A. at 228; 67 Cong. Rec. 3232 (1926); H.R. Rep. No. 83, 69th Cong., 1st Sess. 3-4 (1926). Congress was legislating to control national banks' underwriting activities, which had sprung up in the early 1900s. In contrast, these banks had dominated the commercial paper market since the middle 19th century. *See* Federal Reserve Statement, *supra* note 3, at 10, J.A. at 229; A. Greef, The Commercial Paper House in the United States at 6-7, 15-18, 403-05 (1938).

57 Ch. 89, sec. 16, 53 Stat. 162, 185 (1933).

58 *See* S. Rep. No. 77, *supra* note 30, at 16 (banks permitted to purchase and sell investment securities "to the same extent as heretofore").

59 The conclusion that commercial paper is not a "security" or "stock" would follow *a fortiori* from the conclusion that commercial paper is not an "investment security." If commercial paper is a security but not an investment security, banks would be entirely forbidden from purchasing, selling, or underwriting commercial paper, while permitted, subject to the regulation of the Comptroller of the Currency, to purchase or sell corporate debt instruments. This would be quite anomalous, for corporate debt instruments threaten to a far greater degree to cause the evils at which the Glass-Steagall Act is aimed. Moreover, if commercial paper were deemed to be a "note" within section 21 of the Glass-Steagall Act, it ought also to be a "marketable obligation[ ] evidencing indebtedness . . . in the form of [a] note[ ]"—*i.e.*, an "investment security"—under section 16. That the legislative history and administrative implementation of the McFadden Act indicate clearly that commercial paper is not an "investment security" implies therefore that it should not be considered a "note" for the purposes of the Glass-Steagall Act.

D. *The Analogy to the Securities Laws*

Plaintiffs suggest that we may infer Congress' intent from its use of the term "security" in two contemporaneous statutes—the Securities Act of 1933 and the Securities Exchange Act of 1934. Both acts define "security" to include "any note."[60] There is no reason, however, to assume that Congress intended that term to bear the same meaning in these different statutory contexts. Congress enacted the Glass-Steagall Act primarily to protect *bank depositors.*[61] By contrast, "[t]he primary purpose of the [Securities Acts] of 1933 and 1934 was to eliminate serious abuses in a largely unregulated securities market. The focus of the Acts is on the capital market of the enterprise system: the sale of securities to raise capital for profit-making purposes, the exchanges on which securities are traded, and *the need for regulation to prevent fraud and to protect the interest of investors.*"[62]

Therefore, although Congress used the term "securities" in both the Glass-Steagall and the Securities Acts, different interpretations of "securities" may follow upon the differing regulatory purposes behind the Acts.[63] "Because securities transactions are economic in character Congress intended the application of [the Securities Acts] to turn on the *economic realities underlying a transaction. . . .*"[64] Similarly, the Court has defined the term "securities" in the Glass-Steagall Act by

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60 15 U.S.C. § 77b(1)(1976) (Securities Act); *id.* § 78c(a)(10) (Securities Exchange Act).

61 *ICI II, supra* note 22, 450 U.S. at 61 & n. 27, 101 S.Ct. at 984 & n. 27. *See generally supra* pp. 141-143 [11a-13a].

62 *United Housing Found., Inc.* v. *Forman*, 421 U.S. 837, 849, 95 S.Ct. 2051, 2059, 44 L.Ed.2d 621 (1975) (emphasis added).

63 The Supreme Court's recent interpretations of these provisions of the Glass-Steagall Act make no reference at all to the securities laws. *See generally ICI I, supra* note 37; *ICI II, supra* note 22.

64 *United Housing Found., Inc.*, 421 U.S. at 849, 95 S.Ct. at 2059 (emphasis added).

analyzing the economic policy behind the Act—to protect bank depositors from the hazards which ensue when commercial banks enter the investment banking business.[65] In short, the Glass-Steagall Act uses the term "security" to fence off investment banking activities from commercial banks; the securities laws use the term to define the capital markets whose economic functioning is to be regulated by the securities laws. Clearly, the scope of the term may differ in these differing contexts. We must assign the term "security" a different meaning in the Glass-Steagall and the Securities Acts if a different interpretation is called for by the respective policies of those Acts.[66]

The Supreme Court recently reaffirmed this approach to the Securities Acts in *Marine Bank* v. *Weaver.*[67] "The [Securities Exchange] Act was adopted to restore *investors' confidence in the financial markets.* . . . We have repeatedly held that the test [of whether an instrument is a "security"] 'is what character the instrument is given in commerce by the terms of the offer, the plan of distribution, and the economic inducements held out to the prospect.' "[68] Therefore, "[e]ach transaction must be analyzed and evaluated on the basis of the content of

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65 *See infra* p. 148 [23a-25a] & notes 72-76.

66 Appellees emphasize that, because Congress *defined* "security" in the Securities Act to include "any note," it must have intended "security" in the Glass-Steagall Act to mean the same thing. But all the example of the Securities Acts shows, of course, is that Congress is capable of using "securities" to include "all notes" when it clearly defines the term in that way. Indeed, the example of those Acts suggests that, if Congress had intended so sweeping a definition of "security" in the Glass-Steagall Act, it would have enunciated such a definition in the Act. *Cf. American Tobacco Co.* v. *Patterson*, U.S. at n. 6, 102 S.Ct. 1534 at 1539 n. 6, 71 L.Ed.2d 748 ("fundamental distinction" should not be imported into a statute unless Congressional intent is clearly expressed); *Touche Ross & Co.* v. *Redington*, 442 U.S. 560, 572, 99 S.Ct. 2479, 2487, 61 L.Ed.2d 82 (1979) ("when Congress wished to provide [remedy], it knew how to do so and did so expressly").

67 ____ U.S.____, 102 S.Ct. 1220, 71 L.Ed.2d 409 (1982).

68 *Id.* at ____, 102 S.Ct. at 1222 (emphasis added) (citations omitted).

the instruments in question, the purposes intended to be served, and the factual setting as a whole."[69]

In deciding that a certificate of deposit was not a security, *Marine Bank* noted two facets of the economics of these certificates: first, holders receive a fixed rate of interest rather than dividends based on profits; second, "[i]t is unnecessary to subject issuers of bank certificates of deposit to liability under . . . the federal securities laws since the holders of bank certificates of deposit are abundantly protected under federal banking laws."[70] In short, the Court focused on the potential economic gains and losses of the *investors*, who are the intended beneficiaries of federal securities regulation, in deciding whether the purposes of that regulation would be furthered by its application to the instrument in question. A different focus of analysis is called for under the Glass-Steagall Act, which aims at protecting the integrity of *banks* and the financial resources of *depositors* rather than *investors*.

We conclude that the meaning of the term "securities" under the securities laws is of little immediate relevance to the problem before us; rather, the example of these laws suggests the need for a careful economic analysis of the commercial paper market itself.

E. *Functional Analysis of Commercial Paper*

The language and the legislative history of the Glass-Steagall Act strongly suggest that commercial paper should be viewed as a loan rather than as a "security" for the purposes of the Act. However, as we have seen, neither the language nor direct evidence from the legislative history is decisive of the question before us. There is no foolproof formula by which we can decide whether the commercial paper marketed by Bankers Trust constitutes a "security." Rather, as the Board observed,

> a broad generic or literal reading of the term "security" would likely encompass a number of instruments that

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69 *Id.* at ____, n. 11, 102 S.Ct. at 1225, n. 11.

70 *Id.* at ____, 102 S.Ct. at 1225.

> banks routinely deal with in the course of their business and would, consequently, be contrary to the basic purpose of the Act. On the other hand, a highly technical or formalistic approach might permit evasions of the mandate of Congress.[71]

Because neither the literal language of the statute nor other expressions of congressional intent available to us directly indicate whether commercial paper is a "security," it is necessary to conduct a "functional analysis" of Bankers Trust's commercial paper to resolve this question. The problem becomes whether classifying commercial paper as a "security" would further the policies of the Act. As the Board phrased this inquiry:

> [I]f a particular kind of financial instrument evidences a transaction that is more functionally similar to a traditional commercial banking operation than to an investment transaction, then fidelity to the purposes of the Act would dictate that the instrument should not be viewed as a security.[72]

In adopting this functional analysis, the Board followed the Supreme Court's reasoning in its recent cases construing the Glass-Steagall Act. In *Investment Company Institute* v. *Camp* (*ICI I*) the Court noted that

> Congress was concerned that commercial banks in general and member banks of the Federal Reserve System in particular had both aggravated and been damaged by stock market decline partly because of their direct and indirect involvement in the trading and ownership of speculative securities. The Glass-Steagall Act reflected a determination that policies . . . which might otherwise support the entry of commercial banks into the investment banking business were outweighed by the "hazards"

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71 Federal Reserve Statement, *supra* note 3, at 19, J.A. at 237.

72 *Id.*

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71 Federal Reserve Statement, *supra* note 3, at 19, J.A. at 237.

72 *Id.*

and "financial dangers" that arise when commercial banks engage in the activities proscribed by the Act.[73]

Thus, if confronted with a banking practice which involves the sale of securities and for that reason threatens the "hazards" at which the Act is aimed, neither the Federal Reserve Board nor this court is free to "balance" these hazards against the perceived benefits of the proposed practice. If the practice does *not* threaten to cause these hazards, however, we need undertake no such balancing. Rather, we effectuate the will of Congress by concluding that the proposed banking practice is not within the scope of the statutory proscription.

For example, in *ICI I* the Court found that the bank's sale of participations in a bank-sponsored mutual fund posed the dangers that the Glass-Steagall Act was designed to prevent; the Court concluded that these participations were securities within the meaning of the Act.[74] Once these participations were found under this functional analysis to be "securities," the "literal language" of the Act prohibited sale by the bank.[75]

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73 *ICI I, supra* note 37, 401 U.S. at 629-30, 91 S.Ct. at 1098.

74 *Id.* at 635-38, 91 S.Ct. at 1101-02.

75 *Id.* at 639, 91 S.Ct. at 1103. *See also ICI II, supra* note 22, 450 U.S. at 65-66, 1-1 S.Ct. at 986 (analyzing *ICI I*) ("This Court's . . . determination [that the units of participation were securities] led inexorably to the conclusion that § 16 had been violated."). *ICI II* posed a different problem of statutory interpretation, as the Court itself noted. *Id.* at 66, 101 S.Ct. at 986. There, it was indisputable that the transactions under scrutiny involved "securities"; the question before the Court was whether the banks were "engaged in the business of issuing, underwriting, selling, or distributing" securities. Again, the Court embarked upon an analysis of the "hazards contemplated [by] Congress in enacting the Glass-Steagall Act" in order to conclude that the Act had not been violated. *Id.* at 66-67, 101 S.Ct. at 986-87.

Because we find that the commercial paper marketed by Bankers Trust is not a "security," we need not reach the issue, which arose in *ICI II*, of whether the bank is engaged in "underwriting" within the meaning of the Glass-Steagall Act.

The Federal Reserve Board, in resolving the present case, therefore correctly focused on whether the commercial paper marketed by Bankers Trust functioned economically as a loan or as a security. Only if commercial paper displayed the economic characteristics of a "security" would the marketing of commercial paper by Bankers Trust cause the hazards the Act was designed to prevent. The Board concluded that, in all relevant respects, the commercial paper had the economic characteristics of a loan.[76] We agree.

It is useful to review the traditional lending functions of commercial banks. The commercial lender extends *short-term* credit to businesses to finance immediate needs for working capital.[77] To assure itself of timely repayment, the commercial bank carefully evaluates the credit-worthiness of the borrower and the borrower's representations as to the use of funds. In recent years, the lender has characteristically been either a bank or a syndicate of lenders, which may include banks and lending institutions such as credit or mortgage companies.[78]

We find that the commercial paper at issue here has the economic characteristics of a traditional loan. Purchase of commercial paper, like lending by a commercial bank, represents a very reliable means by which the lender may earn a return on excess cash over a short period of time. Several features of the commercial paper market are salient in this respect.

First, the default rate on commercial paper is extremely low: only highly solvent corporations, with the best possible bond ratings, are able to market commercial paper. Indeed, the default rate on commercial paper is much lower than that on

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76 Statement, *supra* note 3, at 17-20, J.A. at 236-39.

77 *See, e.g.*, D. Hayes, Bank Lending Policies 89-91 (1977); J. Culbertson, Money and Banking 308-09 (2d ed. 1977). In considering the Glass-Steagall Act, Congress emphasized the distinction between short-term and long-term capital financing. *See supra* p. 145 [18a] & notes 52-53.

78 *See* Pollock, *Notes Issued in Syndicated Loans—A New Test to Define Securities*, 32 Bus. Lawyers 537, 538 (1977).

ordinary commercial loans made to high-grade commercial customers.[79]

Second, Bankers Trust commercial paper, like most commercial loans, is of very short maturity: it is generally redeemable at face value within 30 to 90 days.[80] Short maturity not only makes commercial paper a very liquid investment; it also reduces risk, because the financially strong corporations which can issue commercial paper are unlikely to deteriorate over the short period during which purchasers must hold the paper.

Third, because commercial paper is sold by Bankers Trust in denominations averaging one million dollars or more,[81] this paper is placed only with sophisticated purchasers—large institutions such as pension funds, money market mutual funds, insurance companies and nonfinancial corporations with large amounts of idle cash.[82] These purchasers, like commercial banks, are well able to evaluate the riskiness of the investments by verifying representations about the issuers. Three indepen-

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79 Federal Reserve Statement, *supra* note 3, at 3, J.A. at 222; Hurley, *supra* note 5, at 526-29. The Board's empirical studies found that the default rate on commercial paper is only a fraction of that on commercial loans. Companies which began to experience financial difficulties, such as Chrysler Financial Corp. and International Harvester Credit, must withdraw from the commercial paper market. Ironically, these corporations turn to commercial banks to meet their needs for current funding.

80 *See* Report from the Board's On-site Investigation of Bankers Trust 2 (8 May 1980) (average maturity of Bankers Trust notes 60 days), J.A. at 200 [hereinafter cited as Report]; Federal Reserve Statement, *supra* note 3, at 2, J.A. at 221. *See also* Hurley, *supra* note 5, at 530; Comment, *supra* note 5, at 364. According to a Federal Reserve Board survey, the maturities of short-term commercial and industrial loans range from 36 to 105 days. 67 Fed. Res. Bull. A26 (Dec. 1981).

81 *See* Report, *supra* note 80, at 2, J.A. at 200. The minimum denomination Bankers Trust will sell is $100,000.

82 Hurley, *supra* note 5, at 529; Comment, *supra* note 5, at 362-66.

dent rating services also conduct thorough periodic investigations of issuers' financial condition.[83]

For all these reasons, investment in commercial paper, far from resembling securities speculation, is less risky even than banks' ordinary commercial lending.[84] The key difference between the commercial paper sold by Bankers Trust and the traditional lending of commercial banks is that capital is lent by other investors rather than by the bank.[85] In the traditional loan transaction, the commercial bank *purchases* commercial paper; in the present case, the bank acts as agent in the *sale* of commercial paper. The bank is simply on the other side of the transaction. The question which faced the Board is whether commercial paper should be considered a "security" merely because the bank acts as the seller rather than the purchaser of the commercial paper—*i.e.*, whether the role of the bank in and of itself makes the transaction one prohibited by the Glass-Steagall Act.[86]

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83 *See* sources cited at note 82 *supra*.

84 Notably, securities differ strikingly from loans in all three respects. First, purchasers of securities, unlike purchasers of commercial paper, may liquidate their holdings, if at all, only at whatever price the market is currently paying for the stock. Second, because this price will fluctuate with the fortunes of the firm and with general economic conditions, holding securities is risky (though of course the degree of risk will depend on the profitability of the enterprise and the terms of the security agreement). Third, securities are generally available in much smaller denominations than commercial paper, so that they may be traded by the public on the open market.

85 Federal Reserve Statement, *supra* note 3, at 19, J.A. at 238. When Congress passed the Glass-Steagall Act, this difference was less marked than it has been in recent years: banks not only arranged loans in private transactions, but also purchased the vast bulk of instruments sold through the commercial paper market. *See id.* at 18, J.A. at 237; Hurley, *supra* note 5, at 529. *Compare supra* p. 148 [25a] & n. 78 (in commercial bank loan, lender may be either the bank itself or a syndicate of other lenders).

86 *See Becker*, 519 F. Supp. at 615-16.

We agree with the Board that Bankers Trust may sell as well as purchase commercial paper. The bank's role as seller does not threaten the bank with those dangers which the Glass-Steagall Act was designed to prevent. Because commercial paper is like a loan rather than a security, marketing of commercial paper by the bank does not have the same economic impact on the bank as would marketing of securities.

This is confirmed by an analysis of the dangers which the Glass-Steagall Act was designed to prevent.[87] One such danger was that bank underwriting of *securities* may "tie up" depositors' funds in speculative securities. Bankers Trust's sale of commercial paper does not create this danger because of the features of commercial paper already noted. First, the bank acts simply as an agent in the sale of commercial paper; it does not agree to purchase the paper on its own account—*i.e.*, with the funds of depositors.[88] Second, commercial paper is of prime quality, sold only by corporations with well-established credit ratings: commercial paper is not a "speculative" holding.[89] Third, commercial paper is held by the lender only for 30 to 90 days:[90] the lender may readily convert his holdings to cash and does not bear the risk of long-term fluctuations in the value of the enterprise.

The other set of dangers addressed by the Glass-Steagall Act comprises the conflicts of interest that arise when a commercial bank underwrites securities.[91] Again, Bankers Trust does not face these conflicts.

First, the bank cannot use its credit facilities in order to facilitate sale of its commercial paper. Because the interest on a commercial loan is higher than that paid out on commercial

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87 *See supra* pp. 141-43 [11a-13a].

88 Report, *supra* note 80, at 4, J.A. at 202; Federal Reserve Statement, *supra* note 3, at 2.

89 *See supra* pp. 148-149 [25a-27a].

90 *See supra* p. 149 [26a-27a].

91 *See supra* pp. 142-143 [12a-13a].

paper, a purchaser of commercial paper would not use a commercial loan to finance its purchases.[92] Conversely, the bank is under no incentive to advance unsound loans to shore up its issuers of commercial paper, because these issuers must be, by the nature of the commercial paper market, financially sound.[93]

Second, Bankers Trust is not in a position to abuse its reputation for prudence, or give unreliable financial advice to its depositors, in order to promote the sale of commercial paper. Commercial paper is purchased only by large sophisticated buyers who are capable themselves of evaluating the wisdom of their investment.[94] Moreover, commercial paper is very low-risk, and is issued only by very solvent corporations about whose financial prospects information is widely available.[95] It is inconceivable that a commercial bank such as Bankers Trust could, under these conditions, seek improperly to influence potential purchasers of commercial paper.[96]

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92 *See* Guidelines, *supra* note 13, at 29334. *See also* Report, *supra* note 80, at 4, J.A. at 202 (no evidence that funds borrowed from Bankers Trust are used to purchase its commercial paper).

93 *See supra* pp. 148-149 [25a-27a].

94 *See supra* p. 149 [26a-27a].

95 *See supra* p. 148 [25a-26a].

96 Finally, Bankers Trust may not "dump" its commercial paper through its trust department, for the Federal Reserve Guidelines prohibit bank sales of commercial paper to fiduciary accounts to which the bank gives investment advice. *See* Guidelines, *supra* note 13, at 29335 (Guideline #7). Insofar as the conflict of interest presented here may be entirely eliminated by an authorized regulation of the Board, it can hardly be said to pose one of the "subtle hazards" against which the Act is directed. *ICI I*, *supra* note 37, 401 U.S. at 630, 91 S.Ct. at 1098. *See also ICI II*, *supra* note 22, 450 U.S. at 66-67, 101 S.Ct. at 986 (relying on Board guidelines in finding no "underwriting" by banks); *cf. Marine Bank*, ___ U.S. at ___, 102 S.Ct. at 1225 (regulation of certificates of deposit by securities laws unnecessary because of extensive federal banking regulation).

Finally, the bank's reputation for prudence *will not suffer* by its association with the issue of commercial paper. Commercial paper is a highly sound short-term investment. And even if a commercial paper issuer were to default, the sophisticated purchasers of commercial paper will understand that this paper is not backed by the guarantees on commercial bank deposits.

The Board's "functional analysis" leads inexorably to the conclusion that Bankers Trust's commercial paper is not a "security" within the meaning of the Glass-Steagall Act. Transactions in commercial paper display the key economic characteristics of a commercial bank loan; and, because of these characteristics, Bankers Trust's dealings in commercial paper pose none of the hazards the Glass-Steagall Act was designed to prevent.

IV. CONCLUSION

We thus agree with the Board that Bankers Trust may continue to deal in commercial paper without violating the Glass-Steagall Act. The commercial paper it markets is not a "security" within the prohibitions of the Act. Moreover, our reasoning applies to other commercial paper which falls within the Board's guidelines—*i.e.*, prime quality commercial paper, of maturity less than nine months, sold in denominations of over $100,000 to financially sophisticated customers rather than to the general public.[97] Commercial banks which deal in this paper are not subject to the risks which the Glass-Steagall Act was designed to prevent. We hold therefore that commer-

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97 *See* Guidelines, *supra* note 13, at 29334 (Guideline # 1). The Board's Guidelines, in addition to defining permissible types of commercial paper and permissible purchasers and sellers, require forms of disclosure, record-keeping, and credit analysis by commercial banks. *See supra* p. 8. These requirements are directed against the danger that sale of third-party commercial paper might involve "unsafe or unsound [banking] practices." In finding that the transactions regulated by the Guidelines do not involve a sale of *securities*, we do not rely on these additional requirements.

cial banks may sell third party commercial paper provided that they comply with the Board's guidelines.

It is appropriate to note, however, the limits to this holding. It is conceivable that another type of commercial paper—*e.g.*, of smaller denominations, or issued to the general public—might be a "security" under the Glass-Steagall Act. Commercial bank involvement in the market for such commercial paper may well undermine bank solvency or create unavoidable conflicts of interest. Moreover, the present case does not require us to decide whether Bankers Trust is engaged in "underwriting." A commercial bank is permitted to underwrite commercial paper so long as commercial paper is not a "security." If other species of commercial paper prove to be a "security," however, the issue what constituted "underwriting" of commercial paper would then have to be decided.

Our opinion does not touch directly on other species of commercial paper. As the commercial paper market and banking practices continue to evolve, the Board will be called upon to determine in varying fact situations the scope of activities that Congress intended to permit banks to undertake. But these hypothetical situations are irrelevant to the problem before us. Because the Board correctly applied its functional analysis to the instant case, the judgment of the district court is *Reversed*.

ROBB, *Senior Circuit Judge,* dissenting:

I dissent. In my opinion the majority's holding contravenes the fundamental policy of the Glass-Steagall Act. That Act seeks to insulate commercial banking from the hazards inherent in investment banking by mandating a complete separation of those two functions. The majority decision violates this separation of functions by finding no difference under the Act between a lender in a commercial loan transaction and a seller in the sale of third-party commercial paper.

Although offering various justifications, the majority ultimately rests its holding on a "functional analysis" of Bankers

Trust's third-party commercial paper sales. In its functional analysis, the majority dismisses the difference between the bank's role as "purchaser" in a commercial loan transaction and its role as "seller" in a third-party commercial paper transaction as a case of the bank "simply [being] on the other side of the transaction." *Ante* at 150 [27a]. This distinction, however, is determinative under the Act. Through the Act Congress sought a complete separation of commercial banking from investment banking. *See Investment Co. Institute* v. *Camp*, 401 U.S. 617, 629, 632, 91 S.Ct. 1091, 1098, 1099, 28 L.Ed.2d 367 (1971). *See also Board of Governors of Federal Reserve System* v. *Investment Co. Institute*, 450 U.S. 46, 62, 101 S.Ct. 973, 984, 67 L.Ed.2d 36 (1981). The critical distinction between commercial banking and investment banking is the bank's role in the transaction.

When a bank lends money it is the investor. Following a thorough credit analysis of the potential borrower, the bank decides whether to approve the loan. A loan that the bank has approved and funded constitutes an asset of the bank for which the bank has placed its funds at risk. The bank's generation of income and collection of principal are dependent on the wisdom of the bank's credit decision, the adequacy of the loan provisions, and the bank's perseverance in collecting the loan.

In contrast, when a bank markets third-party commercial paper, it is the seller, not the investor. As seller, the bank has less incentive to conduct a thorough credit analysis of the commercial paper issuer because the bank, unlike an investor, does not place its funds at risk. The bank earns its fee upon closing the sale of the commercial paper. Once the sale is complete, the bank has no direct financial interest in the issuer's ability to meet its commercial paper obligations.

Ignoring the differences in the bank's roles as lender and as seller, the majority characterizes commercial loans as "short-term" transactions and then avers that selling commercial paper is no different than making a commercial loan because both transactions have short maturities. *Ante* at 143-144 [25a-27a]. This analysis fails for two reasons. First, any interpreta-

tion of the Act must focus on the bank's role in the transaction with a view to maintaining the Act's separation of banking functions. The majority's focus on maturities provides no help in determining whether the bank's role in the transaction violates the Act. Second, the basic premise of the majority's analysis is incorrect. Commercial lending is not limited to short-term loans. Longer maturity loans for the acquisition of fixed assets and for permanent increases in working capital are important commercial lending services which the majority conveniently ignores. *See* D. Hayes, *Bank Lending Policies*, 89, 107, 109 (2d ed. 1977); G. Munn, *Encyclopedia of Banking and Finance* 892 (7th ed. 1973). *See generally Business Loans of American Commercial Banks* chs. 7, 9 (B. Beckhart ed. 1959).

Similarly, an analogy between commercial paper sales and commercial loans, based on low default rates and the sophistication of the investors, *ante* at 144 [25a-27a], is not helpful. Relying on these factors, a bank could transform "transactions unquestionably at the heart of the securities industry into permissible activity for commercial depository banks." *A.G. Becker, Inc.* v. *Board of Governors of the Federal Reserve System*, 519 F.Supp. 602, 615 (D.D.C. 1981).

The majority says that analysis of the hazards of mixing commercial and investment banking "confirms" the result reached through its functional analysis. I reach the opposite conclusion. In *Investment Co. Institute* v. *Camp*, 401 U.S. 617, 91 S.Ct. 1091, 28 L.Ed.2d 367 (1971), the Supreme Court lists several hazards that arise when commercial banks become peddlers of securities. First, commercial banks may suffer losses from imprudent security investments. *Id.* at 630, 91 S.Ct. at 1098. Second, "the bank's salesman's interest might impair its ability to function as an impartial source of credit." *Id.* at 631, 91 S.Ct. at 1099. Third, commercial banks may lose customer good will if their depositors suffer losses on investments made in reliance on the bank's involvement in the transaction. *Id.* Fourth, commercial banks may use their reputation for prudence to further their securities sales and subject that reputation to the risks necessarily incident to the investment banking business. *Id.* at 632, 91 S.Ct. at 1099. Finally,

the bank's promotional interests could conflict with its commercial banker obligation to render disinterested investment advice. *Id.* at 633, 91 S.Ct. at 1100.

The majority makes short work of the hazards discussed in the *Camp* decision. Those hazards, in the majority's view, are irrelevant here because commercial paper is a "prime quality", "very low-risk" investment, issued by "financially sound" issuers, and sold to "sophisticated" investors. *Ante* at 150-151 [28a-30a]. The majority's self-fulfilling analysis misses the point. "Prime quality" and "very low-risk" are characterizations that are justified only after an investment has been terminated without any investor loss. The drafters of the Act were certainly more wary of such characterizations in 1933 than the majority is today. The Act has no provision permitting bank sales of securities which are "prime quality" or "very low-risk".

To determine whether the bank's sale of third-party commercial paper involves the hazards that the Act seeks to prevent, we must take the perspective of the Act's drafters. The recent Penn Central experience provides such a perspective. *See generally* Staff of Securities & Exchange Commission, 92d Cong., 2d Sess., *Report to Special Subcomm. on Investigations of the House Comm. on Interstate and Foreign Commerce, The Financial Collapse of the Penn Central Company* (Subcomm. Print 1972) [hereinafter cited as *Penn Central Report*]. As a consequence of its bankruptcy on June 21, 1970 the Penn Central Transportation Company defaulted on $82.5 million in commercial paper. *Id.* at 1. Goldman, Sachs & Co., the nation's largest commercial paper dealer, had sold the commercial paper during the seven months preceding the bankruptcy. *Id.* at 290. The National Credit Office, a wholly-owned subsidiary of Dun & Bradstreet, Inc., had given Penn Central's commercial paper its highest rating, "prime", until June 1, 1970. *Id.* at 283. The investors, whom Goldman, Sachs & Co. described as "sophisticated" and "capable of making their own investment decisions," had purchased Penn Central commercial paper in $100,000 denominations. *Id.* at 290.

A review of the *Camp* warnings in light of the Penn Central experience presents a picture very different from that which the

majority draws. First, although Bankers Trust makes no commitment to purchase unsold commercial paper, it makes clear in its promotional letter to commercial paper issuers that such purchases are within the ambit of its investment services.

> However, in those rare occasions in which we would be unable to satisfy all of [the issuer's] requirements through the placement of paper with investors, we may, from time-to-time and without prior commitment, lend [the issuer] money at the commercial paper rate, and take back a commercial paper note.

(J.A. at 61). *See also* J.A. at 27, 50. The majority states that bank purchases of commercial paper would not present a problem because commercial paper is "prime quality, [is] sold by corporations with well-established credit ratings," and is a short-term investment. *Ante* at 150 [28a-30a]. Yet a bank's purchase of Penn Central's commercial paper which fit the majority's criteria just three weeks before it became worthless, would have been a perfect example of the hazard of "imprudent investment" that the Act seeks to prevent.

Second, the majority states that commercial paper issuers are "financially sound" companies and, therefore, have no need for commercial loans to strengthen their financial position. *Ante* at 150-151 [28a-30a]. However, as the Penn Central case demonstrates, commercial paper issuers are not exempt from financial difficulties. A bank's interests in handling the issuer's commercial paper sales and in protecting the bank's reputation for sound financial decisionmaking could "distort" its credit decisions or lead to unsound loans" to issuers for whom the bank regularly sells commercial paper. *Investment Co. Institute* v. *Camp*, 401 U.S. at 637, 91 S.Ct. at 1102.

The third hazard discussed in the *Camp* decision arises when a bank sells third-party commercial paper under any circumstances less idealistic than those which the majority envisions. Bank depositors who are financially able to purchase commercial paper in large denominations are likely to be among the bank's most important and influential clientele. Loss of their good will as a result of losses on investments which the bank

recommended and sold could be detrimental to the bank's commercial operations.

Finally, the majority makes the indisputable statement that when a bank sells "very low-risk" commercial paper of "very solvent" corporations to "large, sophisticated" investors the bank is not in a position to abuse its reputation for prudence or to give unreliable financial advice. *Ante* at 150 [28a-30a]. However, commercial paper sales that initially fit the majority's criteria may, before the investors are repaid, create hazards that the Act seeks to prevent.

Goldman, Sachs & Co. sold $5 million of the commercial paper of Penn Central, the nation's fourth largest corporation, to American Express Company, a sophisticated investor, on May 1, 1970. *Penn Central Report* at 286, 291. That sale, following several indications of major problems at Penn Central, *id.* at 279-86, and preceding the Company's collapse by just seven weeks, demonstrates the hazards present when there is a financial incentive to give unreliable advice. Had Bankers Trust been Penn Central's securities peddler, the association with Penn Central's collapse together with the resulting lawsuits which the bank would have had to defend would have severely damaged the bank's reputation for financial prudence. *See* Comment, *The Commercial Paper Market and the Securities Acts*, 39 U.Chi.L.Rev. 362, 378-79 nn. 112-13 (1972).

We must analyze the Act with the intent of its drafters as our guide. The Act was a "drastic step", *Investment Co. Institute* v. *Camp*, 401 U.S. at 629, 91 S.Ct. at 1098, taken during a bleak period in our country's banking history. Its drafters intended a complete separation of commercial banking from investment banking without regard to the likely "soundness" of the securities which a bank might sell. Senator Bulkley stated this uncompromising position at the time of the Act's passage: "If we want banking service to be strictly banking service, without the expectation of additional profits in selling something to customers, we must keep the banks out of the investment security business." *Investment Co. Institute* v. *Camp*, 401 U.S. at 634, 91 S.Ct. at 1100 (quoting 75 Cong. Rec. 9912 (1932) (remarks of Sen. Bulkley)). Permitting a bank

to sell third-party commercial paper presents the same hazards that "Congress determined . . . made it necessary to prohibit . . . [investment banking] activity to commercial banks." *Investment Co. Institute* v. *Camp*, 401 U.S. at 636, 91 S.Ct. at 1101. As a result, we must look closely to determine whether the Act prohibits banks from selling third-party commercial paper.

Unlike the majority, I find the Act's language helpful in determining whether commercial paper is a "note" or "security". For our purposes the Act raises two issues. The first issue is whether commercial paper is an instrument with which the Act is concerned—"stocks, bonds, debentures, notes, or other securities," 12 U.S.C. § 378(a)(1) (1976). The second issue is whether Bankers Trust is engaged in the "issuing, underwriting, selling, or distributing," *id.*, activities which the Act prohibits.

The majority characterizes the terms "stocks", "bonds", "debentures", and "notes" as "specific type[s] of long-term investment securit[ies]." *Ante* at 143-144 [15a]. The majority concludes that a broader definition of the term "notes" would be inappropriate because it would include instruments such as commercial paper "which have little in common with these long-term investment securities." *Ante* at 144 [15a]. The majority's reliance on maturities to force a narrow meaning onto the terms of the Act is misplaced. The Supreme Court has interpreted the Act's terms broadly.

> [N]othing in the phrasing of either § 16 or § 21 . . . suggests a narrow reading of the word "securities." To the contrary, the breadth of the term is implicit in the fact that the antecedent statutory language encompasses not only equity securities but also securities representing debt.

Investment Co. Institute v. *Camp*, 401 U.S. at 635, 91 S.Ct. at 1101. *See also Board of Governors of Federal Reserve System* v. *Investment Co. Institute*, 450 U.S. at 65, 101 S.Ct. 986. The terms "stocks", "bonds", "debentures", and "notes" have broad meanings which encompass a multitude of different instruments. The term "other securities" further indicates the

breadth of the Act's coverage; it catches any instruments which are not otherwise defined by the prior four terms. Taken as a group these five terms cover the spectrum of instruments which a corporation might seek to market. Relying "squarely on the language . . . of the Glass-Steagall Act," *Board of Governors of Federal Reserve System* v. *Investment Co. Institute*, 450 U.S. at 65, 101 S.Ct. at 986. I would find that commercial paper is a type of instrument with which the Act is concerned.

Although analysis of the Act's terms and of the hazards with which the Act is concerned requires a finding that commercial paper is a "note or other security" under the Act, our inquiry is not complete. There remains the second issue of whether Bankers Trust's commercial paper sales is an activity which the Act prohibits. However, neither the Federal Reserve Board nor the District Court reached this second issue. *A.G. Becker Inc.* v. *Board of Governors of Federal Reserve System*, 519 F. Supp. 602, 616 n. 10 (D.D.C. 1981). Therefore the second issue is not before us on this appeal.

I would affirm the District Court's finding that commercial paper is a "note or other security" under the Act, and would remand this case for the further determinations suggested in this dissent.

Opinion of the District Court,
July 28, 1981

UNITED STATES DISTRICT COURT
DISTRICT OF COLUMBIA

Civ. A. Nos. 80-2614, 80-2730

July 28, 1981

A.G. BECKER INCORPORATED,

Plaintiff,

v.

BOARD OF GOVERNORS OF THE
FEDERAL RESERVE SYSTEM, et al.,

Defendants.

SECURITIES INDUSTRY ASSOCIATION,

Plaintiff,

v.

BOARD OF GOVERNORS OF THE
FEDERAL RESERVE SYSTEM, et al.,

Defendants.

APPEARANCES:

Harvey L. Pitt, Henry A. Hubschman, Edson G. Case, Jr., Fried, Frank, Harris, Shriver & Kampleman, Washington, D.C., for Becker.

John M. Liftin, James B. Weidner, Janet R. Zimmer, Rogers & Wells, Washington, D.C., for SIA.

Richard M. Ashton, Neal L. Petersen, James V. Mattingly, Jr., Federal Reserve Board, Washington, D.C., for defendants.

JOYCE HENS GREEN, *District Judge.*

Pending before the Court in these consolidated actions are the parties' cross motions for summary judgment and the defendant's alternative motion to dismiss, with supporting memoranda. Plaintiffs are A.G. Becker, Inc. ("Becker"), a securities broker and dealer registered with the Securities and Exchange Commission, and the Securities Industry Association ("SIA"), an organization representing over five hundred securities brokers and dealers. They challenge a decision of the Board of Governors of the Federal Reserve System ("the Board"), which, with its individual members, are the defendants in this action. The dispute presents provocative questions concerning the delicately balanced regulatory system enacted by Congress to control the activities of the nation's banks in financial markets.

In the summer of 1978, Bankers Trust Company ("Bankers Trust"), a state chartered member bank of the Federal Reserve System, began offering for sale third party commercial paper, that is, commercial paper issued by corporations not related to the bank.[1] This effort included a marketing campaign aimed at

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1 A succinct definition of commercial paper is offered in Comment, *The Commercial Paper Market and the Securities Acts*, 39 U.Chi. L. Rev. 362 (1972):

> Commercial paper consists of unsecured, short-term promissory notes issued by sales and personal finance companies; by manufacturing, transportation, trade, and utility companies; and by the affiliates and subsidiaries of commercial banks. The notes are payable to the bearer on a stated maturity date. Maturities range from one day to nine months, but most paper carries an original maturity between thirty and ninety days. When the paper becomes

issuers of commercial paper, whereby Bankers Trust agreed to act as a seller of commercial paper, performing services competitive with securities dealers. As part of this advertising, Bankers Trust offered to lend the issuer of commercial paper money equal to the amount of paper to be sold and, if the bank were unable to sell all of the issuer's paper, to take back notes reflecting the amount of paper unsold.

Becker and SIA expressed concern to the staff of the Board of Governors as to the legality of Bankers Trust's actions in a letter sent in November, 1978. Following this correspondence, plaintiffs, along with the General Counsel of the Securities and Exchange Commission ("SEC") and Bankers Trust, filed memoranda arguing over whether the sale by Bankers Trust of third party commercial paper violated certain provisions of the Banking Act of 1933 known as the Glass-Steagall Act. On June 28, 1979, after a meeting with representatives of Becker and SIA, the General Counsel of the Board issued a document entitled "Commercial Paper Activities of Commercial Banks: A Legal Analysis," which concluded that state member banks may, subject to certain limitations, sell third party commercial paper. The General Counsel offered, upon request by Becker or SIA, to recommend that the Board review his opinion. SIA, on July 26, 1979, and Becker, on January 31, 1980, requested that the Board review the General Counsel's opinion and that, in connection with that review, they initiate proceedings against Bankers Trust for violating the Glass-Steagall Act.[2]

> due, it is generally rolled over—that is, reissued—to the same or a different investor at the market rate at the time of maturity.

Id. at 363-64 (footnotes omitted).

2 Because it may affect the jurisdiction over this action, the parties dispute vigorously whether plaintiffs requested that the Board initiate cease and desist proceedings. Suffice it to quote from plaintiffs' precise language:

> This application is intended to . . . renew the SIA's request for formal action by the Board requiring Bankers Trust Company to cease and desist from its illegal activities. (Application of SIA for Review of State Member Bank Action, July 26, 1979 at 3; Record at

The Board took up the matter presented by the Becker and SIA petitions and, on September 26, 1980, issued a letter and a Statement Regarding Petitions to Initiate Enforcement Actions declaring that commercial paper was not a security within the meaning of the Glass-Steagall Act and that therefore Bankers Trust could legally sell third party commercial paper. The Board expressed concern at some potentially unsound practices that might have developed as a result of its ruling, and therefore commenced the drafting of guidelines governing the sale by state member banks of commercial paper.[3] Soon thereafter, the plaintiffs commenced this action seeking judicial review of the Board's conclusion that Bankers Trust was acting

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366) (Citations to the administrative record will be made as "R. at __").

. . . Applicant SIA respectfully asserts that the Board should (1) formally review this matter, (2) Order Bankers Trust to cease and desist from its third party commercial paper activity . . . *Id.* at 20, R. at 383.

. . . this memorandum is submitted to urge the Board . . . to advise Bankers Trust that its current commercial paper marketing activities are inappropriate as a matter of law and policy, and should cease. (Memorandum on Behalf of A. G. Becker Incorporated to the Staff of the Board of Governors of the Federal Reserve System Concerning the Commercial Paper Activities of Bankers Trust Company, January 31, 1980 at 3, R. at 154) The advance of Bankers Trust into the commercial paper market exceeds the boundary of any fair interpretation of where Congress intended the line to be drawn. We respectfully urge the Board, in conformity with the provisions of the Glass-Steagall Act, to issue a declaration to that effect. *Id.* at 47, R. at 198.

The petition submitted by Becker on January 31, 1979, was referred to in their letter exactly one year later seeking review of the General Counsel's opinion.

3 These guidelines were issued in the context of a policy statement on May 28, 1981, effective immediately, to govern the sale of third party commercial paper by state member banks. The Board indicated that it would accept comments on the guidelines through July 31, 1981, and that it will monitor the activities of banks in the commercial paper market to permit modification or supplementation of the guidelines as experience suggests may be fruitful. Plaintiffs' challenge to the Board's action does not include an attack on these guidelines.

within the parameters of the Glass-Steagall Act in offering for sale third party commercial paper.[4]

Surfacing intially in this controversy is the question whether this court, or any court, has jurisdiction to hear this dispute and grant plaintiffs their requested relief. It is beyond dispute that agency action is reviewable absent a showing that Congress specifically and clearly intended to preclude judicial oversight. The Board in this case has the burden of demonstrating that its decision to permit state member banks to sell third party commercial paper is insulated from review. *See Dunlop* v. *Bachowski*, 421 U.S. 560, 567, 95 S. Ct. 1851, 1857, 44 L. Ed. 2d 377 (1975); *Barlow* v. *Collins*, 397 U.S. 159, 166, 90 S. Ct. 832, 837, 25 L. Ed. 2d 192 (1970); *Abbott Laboratories* v. *Gardner*, 387 U.S. 136, 140 n.2, 87 S. Ct. 1507, 1511, 18 L. Ed. 2d 681 (1967). In *Independent Bankers Association of America* v. *Board of Governors of the Federal Reserve System*, 500 F.2d 812 (D.C. Cir. 1974), the Court of Appeals declared that "non-reviewability must be established by a clear showing

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4 Prior to the filing of this action challenging the substance of the Board's ruling, Becker sought relief in this Court for alleged violations by the Board of the Government in the Sunshine Act, 5 U.S.C. § 552b. On November 26, 1980, this Court issued a memorandum opinion containing a declaratory judgment that the defendants violated the Act's premeeting notice requirements but finding that in all other respects, the Board had acted lawfully. That decision, *A. G. Becker Inc.* v. *Board of Governors of the Federal Reserve System*, 502 F. Supp. 378 (D.D.C. 1980), *appeal docketed*, May 4, 1981, will be referred to as *Becker* I.

Additionally, Becker filed, concurrently with this action, a petition in the Court of Appeals for the District of Columbia Circuit, *A. G. Becker, Inc.* v. *Board of Govenors of the Federal Reserve System*, No. 80-2258 (D.C. Cir., filed Oct. 14, 1980), seeking review of the Board's determination that the sale by state member banks of third party commercial paper did not violate the Glass-Steagall Act. The actions were filed in both courts pursuant to the suggestion in the Court of Appeals that "[i]f any doubt as to the proper forum exists, careful counsel should file suit in both the court of appeals and the district court . . . ." *Investment Company Institute* v. *Board of Governors*, 551 F.2d 1270, 1280 (D.C. Cir. 1977). Becker's motion to stay its action in the Court of Appeals is pending.

of Congressional intent to preclude review." *Id.* at 814. Especially where an agency has resolved a pure question of law, which the Board did when it decided that commercial paper was not subject to the proscriptions of the Glass-Steagall Act,[5] courts have a special competence and judicial review is clearly the norm. *See Natural Resources Defense Council, Inc.* v. *Securities and Exchange Commission*, 606 F.2d 1031, 1048 (D.C. Cir. 1979).

The Board contends that the availability of judicial review is governed by the Financial Institutions Supervisory Act of 1966, as amended, which established procedures for the issuance of cease and desist orders by federal agencies with authority over the banking industry. Alternatively, it maintains that its refusal to commence enforcement proceedings against Bankers Trust is a matter committed to its discretion by law and therefore nonreviewable under the Administrative Procedure Act. The plaintiffs strenuously reject that Congess has entrusted the Board with absolute discretion over this matter, suggesting that the Board's interpretation of the Glass-Steagall Act is subject to the normal presumption favoring judicial review absent a showing by the Board of clear deprivation of the Court's jurisdiction. Neither ground for nonreviewability cited by the Board, plaintiffs contend, overcomes the doctrine that permits courts to review agency decision on questions of law.

The Board's initial authority for its argument that jurisdiction lacks is the Financial Institutions Supervisory Act of 1966, as amended, specifically 12 U.S.C. §§ 1818(h), (i). This legislation established procedures for the Federal Deposit Insurance Corporation, the Comptroller of the Currency, and the Board to regulate the nations financial houses and to enforce against

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5 Even the Board recognized that its conclusions necessitated a resolution of a legal question. *See* Letter to plaintiffs' counsel, September 28, 1980 at 3, R. at 664 (". . . the issues involved in these petitions are primarily legal in nature . . . "); Statement Regarding Petitions to Initiate Enforcement Actions, September 28, 1980, at 28, R. at 692 (". . . the Glass-Steagall Act issues resolved by the Board are essentially legal in nature . . . ").

unsafe or unsound banking practices. It provides, in pertinent part:

> (h)(2) . . . any person required by an order issued under this section to cease and desist from any of the violations or practices stated therein, may obtain a review of any order . . . by the filing in the court of appeals of the United States for the circuit in which the home office of the bank is located, or in the United States Court of Appeals for the District of Columbia Circuit . . . a written petition praying that the order of the agency be modified, terminated, or set aside . . . .
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> . . .
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> (i)(1) The appropriate Federal banking agency may in its discretion apply to the United States district court . . . within the jurisdiction of which the home office of the bank is located, for the enforcement of any effective and outstanding notice or order issued under this section, and such courts shall have jurisdiction and power to order and require compliance herewith; but except as otherwise provided in this section no court shall have jurisdiction to affect by injunction or otherwise the issuance or enforcement of any notice or order under this section, or to review, modify, suspend, terminate, or set aside any such notice or order.

Under the Board's view, its decision not to institute cease and desist proceedings and its judgment that commercial paper is not a security under the Glass-Steagall Act are insulated from judicial scrutiny by these provisions. A decision not to adjudicate whether Bankers Trust's conduct was illegal is, in the Board's opinion, analogous to decisions by the Federal Trade Commission and the General Counsel of the National Labor Relations Board exercising their "prosecutorial discretion." *See Moog Industries, Inc.* v. *Federal Trade Commission*, 355 U.S. 411, 78 S. Ct. 377, 2 L. Ed. 2d 370 (1958); *Federal Trade Commission* v. *Klesner*, 280 U.S. 19, 46 S. Ct. 102, 70 L. Ed. 404 (1929) (both holding unreviewable a decision by the Federal Trade Commission not to institute cease and desist pro-

ceedings under section 5 of the Federal Trade Commission Act, 15 U.S.C. § 45) and *National Labor Relations Board* v. *Sears, Roebuck & Co.*, 421 U.S. 132, 138, 95 S. Ct. 1504, 1510, 44 L. Ed. 2d 29 (1975); *Vaca* v. *Sipes*, 386 U.S. 171, 182, 87 S. Ct. 903, 912, 17 L.Ed. 2d 842 (1967) (holding unreviewable a decision of the General Counsel of the Board not to issue an unfair labor practice complaint). The Board also finds shelter for this position in the language of the statute quoted above, in that an injunction directing the Board begin a proceeding to prevent Bankers Trust to sell third party commercial paper would, of necessity, "affect" the issuance of a cease and desist order and thus contravene 12 U.S.C. § 1818(i)(1).

The Board, however, ignores the procedural posture of the proceedings before it and before this Court. 12 U.S.C. § 1818(i) is a narrow statute, applying only to an "order issued under this section." Section 1818 establishes a detailed procedure to govern efforts by the Board to enforce against unsafe and unsound practices. None of these procedures were followed in this case. The Act provides for proper notice, a hearing, service of the Board's findings upon the bank under investigation, and review of the Board's decision in a court of appeals. In this action, Becker and SIA submitted materials to the General Counsel, who issued a legal opinion on the meaning of the Glass-Steagall Act as applied to Bankers Trust's conduct. The General Counsel, while soliciting materials from Bankers Trust, held no formal hearing but rather worked with his staff to reach a resolution of plaintiffs' expressed concerns. He gave the plaintiffs the oportunity to request that he seek review of his own decision by the Board of Governors. Plaintiffs then sought from the Board of Governors a review of the General Counsel's legal opinion and, in connection with that review, the institution of enforcement proceedings. The Board agreed with its General Counsel and decided not to institute an adjudication against Bankers Trust. At this stage, where the plaintiffs are challenging the legal conclusion reached by the General Counsel and adopted by the Board, § 1818 does not proscribe review.

This analysis finds support in *Groos National Bank* v. *Comptroller of the Currency*, 573 F.2d 889 (5th Cir. 1978). The appellate court held that jurisdiction did not vest in the district court to issue a declaratory judgment against the Comptroller, but explicitly found that "the Comptroller [had] set in motion cease and desist proceedings as authorized by 12 U.S.C. § 1818." *Id.* at 892. This is not an action such as *Groos* where "this regulatory process is not to be disturbed by untimely judicial intervention," *id.* at 895, because the administrative process here has reached a final conclusion that the Glass-Steagall Act is not violated when a state member bank sells commercial paper issued by unrelated corporations.

Moreover, it is a well recognized exception to statutes precluding judicial review that if an agency acts beyond the scope of its statutory authority, courts may exercise jurisdiction to overturn that administrative action. *See Manges* v. *Camp*, 474 F.2d 97 (5th Cir. 1973) (decision of Comptroller of the Currency outside of its authority is reviewable notwithstanding § 1818). *See also Leedom* v. *Kyne*, 358 U.S. 184, 79 S. Ct. 180, 3 L. Ed. 2d 210 (1958) (action within discretion of National Labor Relations Board General Counsel is reviewable if he exceeds statutory authority).

Section 1818 does, however, preclude the Court from granting plaintiffs' prayer that an injunction be issued ordering that cease and desist proceedings be commenced against Bankers Trust. *See* Becker Complaint at 11, ¶ 6; SIA Complaint at 8, ¶ 5. It is beyond the jurisdiction of this court, and probably any court, to order the Board, by injunction, writ of mandamus, or otherwise, to begin cease and desist proceedings against a bank. Such a directive would surely intrude upon the limitation set out in § 1818(i)(1), that "no court shall have jurisdiction to affect by injunction or otherwise the issuance . . . of any notice or order under this section . . . ." It is clear, therefore, that the Court's power to grant relief in this action is limited to reviewing the legal conclusion reached by the Board concerning the meaning of the Glass-Steagall Act, and to issuing whatever declaratory order may be appropriate.

As a second and independent ground for its argument that the Court lacks jurisdiction, the Board maintains that its decision that Bankers Trust is not violating the Glass-Steagall Act is wholly within its discretion and therefore unreviewable. The Administrative Procedure Act deprives courts of jurisdiction where "agency action is committed to agency discretion by law." 5 U.S.C. § 701(a)(2). The Supreme Court of the United States has interpreted this withdrawal of jurisdiction as predicated on a showing that nonreviewability must "fairly be inferred," from the regulatory framework, *Barlow* v. *Collins*, 397 U.S. 159, 166, 90 S. Ct. 832, 837, 25 L. Ed. 2d 192 (1970), and that the statutes are drawn such that "there is no law to apply." *Citizens to Preserve Overton Park* v. *Volpe*, 401 U.S. 402, 410, 91 S. Ct. 814, 820, 28 L. Ed. 2d 136 (1971).

Whether a statute is drawn so broadly that there is no law to apply "turns on pragmatic considerations as to whether an agency determination is the proper subject of judicial review." *Natural Resources Defense Council* v. *Securities and Exchange Commission*, 606 F.2d 1031, 1043 (D.C. Cir. 1979). In that decision, the Court of Appeals set out the proper focus of the inquiry:

> . . . we first identify as precisely as possible the aspects of the agency's action against which the challenge is brought. We then evaluate the relevance of three particularly important factors: the need for judicial supervision to safeguard the interests of the plaintiffs; the impact of review on the effectiveness of the agency in carrying out its congressionally assigned role; and the appropriateness of the issues raised for judicial review. Finally, we inquire whether the considerations in favor of nonreviewability thus identified are sufficiently compelling to rebut the strong presumption of judicial review.

Id. at 1044 (citations omitted).

The exact agency action under attack in this case is the Board's ruling that the Glass-Steagall Act is not violated when a state member bank sells third party commercial paper. The Board attempts to characterize its decision as based on more

than a purely legal analysis, but this is just not the case. Although the Board solicited materials from Bankers Trust on its activities, it chose expressly not to rely on this factual material. In the Board's statement it concluded,

> Since, in the Board's opinion, the stronger argument is that commercial paper should not be treated as a security covered by the Glass-Steagall Act, the restrictions of the Act with regard to issuing, underwriting, selling, and dealing in securities do not apply. Thus, it is not necessary to reach the issue of whether the activities engaged in by Bankers Trust are prohibited by the Act.

R. At 688. Notwithstanding the Board's reliance on its special knowledge of the commercial paper market, once it decided not to address any factual matters underlying Bankers Trust's activity, it transformed the proceeding into a purely legal inquiry. Thus, the background of this dispute is materially different from that faced in *New York Stock Exchange* v. *Bloom*, 562 F.2d 736 (D.C.Cir. 1977), *cert. denied* 435 U.S. 942, 98 S.Ct. 1520, 55 L.Ed.2d 538 (1978), where the Court of Appeals decided to dismiss as unfit for review a petition seeking reversal of a decision of the Comptroller of the Currency that a specific automatic stock-investment plan did not violate the Glass-Steagall Act. In that case, the Court expressly noted that the Comptroller had assessed factual matters beyond a mere interpretation of the Act. But the Court was explicit as to how a pure legal question would be presented: "No doubt determining the general interest of Congress from the language and history of the Act is a matter of law. . . ." *Id*. at 741. A perusal of the Board's statements associated with its decision reveals that the Board resolved just a legal question in response to the Becker and SIA petitions. A weighing of the factors then set out in *Natural Resources Defense Council*, *supra*, leaves little doubt that the question presented is not only appropriate for review, but also demands judicial oversight in order to render a proper statutory interpretation.

Although the Board had discretion to make its legal decision, that discretion is neither absolute nor unreviewable. Rather, it represents the sort of administrative adjudication that has been held reviewable in the federal courts for "legal error, procedural defect or abuse." L. Jaffe, *Judicial Control of Administrative Action 362-63 (1965). See Nader* v. *Saxbe*, 497 F.2d 676, 679-80 n. 19 (D.C.Cir. 1974). In *Natural Resources Defense Council*, it was noted that the Administrative Procedure Act itself "command[s] an exacting judicial scrutiny" of agency determinations of "pure questions of law." 606 F.2d at 1048. *See* 5 U.S.C. §§ 706(2)(B),(C),(D). It is difficult to imagine an issue more suited to judicial review than the Board's determination; indeed, the Board's contentions on the merits of this litigation are predicated almost wholly on canons of statutory interpretation and an analysis of legislative history, which belie its claim that there is no law to apply. Moreover, the Board made no showing that review in this case would hamper its effectiveness in the future. It merely maintained that courts should not direct that a specific enforcement tool be chosen, and that the statute's lack of guidance as to when a cease and desist order is appropriate should be respected. Although it is true that § 1818 offers scant direction governing when the Board should institute cease and desist proceedings, whether the Board's legal conclusion is proper rests on inquiries familiar to all courts.

Further, the Board's suggestion that nonreviewability can fairly be inferred from the statutory framework is flawed. Defendants contend that § 1818(b)(1) suggests that courts should not interfere in actions such as this. That section provides that "[i]f in the opinion of the appropriate . . . agency, any insured bank" has violated the law or engaged in an unsafe practice, "the agency may issue" a notice of charges to initiate enforcement proceedings." This section neither expressly nor impliedly affects the review of purely legal determinations. It merely leaves the Board with discretion to decide when to initiate enforcement proceedings. The Board's characterization of its discretion sweeps too broadly, because it attempts to apply this narrowly drawn enactment to insulate

from review any ruling on a wholly legal issue as long as the decision is somehow related to the institution of enforcement actions.[6]

The parties' positions as to the exact nature of the Board's action are not entirely illuminating because, in one sense, they are all only partially accurate. The plaintiffs assert (and it would be difficult to contravene), that the Board issued a ruling on a question of law, *i.e.*, that state member banks, under the Glass-Steagall Act, could permissibly sell third party commercial paper. The Board correctly notes, though, that this decision was pronounced in the context of deciding whether to initiate cease and desist proceedings against Bankers Trust. Neither the judicial nor the administative processes provide for decisions on legal questions in a vacuum; each dispute is occasioned by factual developments that give rise to a particular problem. The difficulty courts face is in effectuating the delicate balance between the smooth exercise of administrative discretion in areas where agencies have expertise and the right of a party aggrieved with an administrative agency's interpretation of a legal question to seek judicial review.

The statutory scheme created in § 1818 precludes judicial interference in the enforcement processes until the appropriate stage, but nothing in § 1818, nor even in traditional canons of administrative law, prevents this Court from reviewing the propriety and correctness of the Board's legal determination that state member banks may sell third party commercial paper.[7] To hold that jurisdiction is abs[illegible] here would be to vest

6 The parties briefed and argued the question whether the Board's decision was ripe for resolution in this Court because, at the time the motions were filed, the Board had not issued the promised guidelines to guard against what it thought to be potential unsafe practices resulting from a state member bank's sale of third party commercial paper. When these guidelines were issued, however, *see n.* 3, *supra*, this issue evaporated from this controversy and hence will not be addressed.

7 This decision by the Board will undoubtedly have far reaching effect, much broader than merely permitting Bankers Trust to continue its commercial paper activity. The Board itself, as it issued guidelines

the Board with unreviewable discretion in any proceeding, limited only to facts presented, to resolve broad legal questions that are particularly within the competence of the courts to decide. Since the Court may not intrude into the congressionally sanctioned enforcement procedures set out in § 1818, and cannot therefore enjoin the Board to institute cease and desist proceedings, the Court's authority is restricted to resolution of the legal question presented and the grant of equitable relief consonant with that decision, within the bounds of appropriate judicial review.[8]

Before proceeding to consider the substance of the Board's conclusion, the parties vociferously dispute the degree of deference to be given the Board's expertise in the regulation of commercial banking in the United States. The Board suggests that its decision is immune from judicial alteration unless arbitrary, capricious, or wholly irrational. Plaintiffs contest this claim, pointing out that they challenge the Board's ruling on a legal question, reversal of which is mandated by the Administrative Procedure Act if not in accordance with the statute. 5 U.S.C. § 706.

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for all banks to follow, recognized that many banks were likely to adopt the route of Bankers Trust.

8 Although not raised by the parties, one final point on the jurisdictional issue warrants mention. In *Becker I*, the Court found that the Board's closure of its meetings on the petitions of *Becker* and *SIA* satisfied exemption 10 of the Sunshine Act, 5 U.S.C. § 552b(c)(10), which permits an agency to refuse to open a meeting concerning a decision to participate in adjudicatory proceedings, because the possibility of cease and desist proceedings was raised and discussed. That finding does not foreclose the determination that the matter on review at this time is the legal determination reached by the Board in conjunction with its decision not to initiate an action against Bankers Trust. The part of the Board's decision which rejected any enforcement proceeding against Bankers Trust is not subject to review, and to the extent that it was likely that proceedings against Bankers Trust might be discussed at the meetings, the Court remains convinced that the meetings were properly closed. That cease and desist proceedings may have been mentioned, however, does not assault the Court's authority to review the Board's resolution of the legal question at issue herein.

Amidst these opposing contentions the Court of Appeals has recently reaffirmed the Court's delicate role in deciding cases such as these:

> We are fully aware of the deference due the construction placed on a statute by an agency charged with the responsibility for administering it. . . . However, to accord deference is not to abdicate our duty to construe the statute, for the "courts are the final authorities and 'are not obliged to stand aside and rubber-stamp their affirmance of administrative decisions that they deem inconsistent with a statutory mandate or that frustrate the congressional policy underlying a statute.' "

National Association of Recycling Industries, Inc. v. *Interstate Commerce Commission*, 660 F.2d 795 at 798-99 (D.C.Cir., 1981). Specifically with regard to federal banking legislation, the Supreme Court has recognized the expertise of the Board in interpreting and administering that statute. *See Board of Governors* v. *Agnew*, 329 U.S. 441, 450, 67 S.Ct. 411, 415, 91 L.Ed. 408 (1947). Nonetheless, the duty to examine the Board's rule to ensure its accordance with the law cannot be shirked. In *National Distributing Co.* v. *United States Treasury Department*, 626 F.2d 997 (D.C.Cir. 1980), the Court noted,

> This Court is vested by statute with the authority and responsibility to "decide all relevant questions of law, interpret constitutional and statutory provisions, and determine the meaning or applicability of the terms of an agency action.". . . We are required to "hold unlawful and set aside agency action, findings, and conclusions found to be . . . not in accordance with the law[.]"

Id. at 1019, *quoting* the Administrative Procedure Act, 5 U.S.C. § 706.

Some illumination of the statutory framework surrounding this litigation is appropriate. The Glass-Steagall Act was part of a package of banking reforms passed during the early part of the Presidency of Franklin Delano Roosevelt. Two of its sections are pertinent to this dispute:

Section 16 (12 U.S.C. § 24) Corporate Powers of Associations

Seventh. . . . The Business of dealing in securities and stock by the association shall be limited to purchasing and selling such securities and stock without recourse, solely upon the order, and for the account of, customers, and in no case for its own account, and the *association shall not underwrite any issue of securities or stock: Provided,* That the association may purchase for its own account investment securities under such limitations and restrictions as the Comptroller of the Currency may by regulation prescribe. . . . As used in this section the term "investment securities" shall mean marketable obligations, evidencing indebtedness of any person, copartnership, association or corporation in the forms of bonds, notes and/or debentures commonly known as investment securities under such further definition of the term "investment securities" as may be prescribed by the Comptroller of the Currency.

* * * * * * * *

Section 21 (12 U.S.C. § 378) Dealers in securities engaging in banking business; individuals or associations engaging in banking business; examinations and reports; penalties.

(a) After the expiration of one year after June 16, 1933, it shall be unlawful—

(1) For any person, firm, corporation, association, business trust, or other similar organization, *engaged in the business of issuing, underwriting, selling or distributing*, at wholesale or retail, or through syndicate participation, *stocks, bonds, debentures, notes, or other securities, to engage at the same time to any extent whatever in the business of receiving deposits* subject to check or to repayment upon presentation of a passbook, certificate of deposit, or other evidence of debt. . . . (Emphasis added).

These provisions are made applicable to state member banks by 12 U.S.C. § 355.

The plaintiffs contend that the Board's decision contravenes the plain meaning of the Glass-Steagall Act because Bankers Trust, an institution in the business of receiving deposits, is, in their view, selling or underwriting commercial paper, which the plaintiffs argue is a security.

The first question to be addressed, then, is whether commercial paper is in fact a "note or other security" for purposes of the Glass-Steagall Act. In its statement asserting several legal bases for accepting the General Counsel's opinion, and in this litigation, the Board has attempted to justify its decision that commercial paper was not included in the Glass-Steagall Act. Section 21, the Board argues, was not intended to prohibit traditional banking functions, and the sale by Bankers Trust of third party commercial paper resembles other banking functions such as the sale of notes and bankers' acceptances to other lenders and the issuance of certificates of deposits. A decision that commercial paper is included within the Act's prohibition would, the Board suggests, jeopardize a host of traditional banking functions. Additionally, the Board analyzed the transaction involved in the sale of third party commercial paper and concluded that such activity resembled a loan, not a sale of securities. Although Congress did not, in 1933, specifically allude to commercial paper in the proceedings over Glass-Steagall, the Board points to indirect evidence that commercial paper was not intended to be included in the definition of "notes or other securities."

Plaintiffs maintain that the plain meaning of the Glass-Steagall Act prohibits exactly what Bankers Trust is doing, mixing the business of banking with the commerce of dealing in securities. The plaintiffs characterize the defendant's "parade of horribles" as irrelevant, because the traditional activities referred to by the Board are specifically permitted by other sections of the banking laws. In the plaintiffs' view what distinguishes Bankers Trust's conduct from other, more traditional banking functions, is the unique role of Bankers Trust, functioning between the issuer and the purchaser of commer-

cial paper. That role, the plaintiffs contend, is precisely what Congress intended to eliminate by its strict separation of investment banking from normal depository banking. Further, plaintiffs reject the Board's "functional anaylsis" that commercial paper is much like a loan, contending that the Board ignored the role of the bank in examining the transaction between the issuer of commercial paper and the purchaser. The plaintiffs also focus on the legislative history of the Glass-Steagall Act to support their position, citing, too, the Securities Act of 1933, which defines "securities" explicitly to include commercial paper. The Congress, plaintiffs proclaim, plainly sought to separate all dealing in speculative and other investments from the normal, more stable business of banking.

All statutory analysis begins with the recognition of an essential truth: "In any case concerning the interpretation of the statute, the 'starting point' must be the language of the statute itself, *Lewis* v. *United States*, 445 U.S. 55 [100 S.Ct. 915, 63 L.Ed.2d 198] (1980). . . ." *National Association of Recycling Industries, Inc.* v. *Interstate Commerce Commission*, 660 F.2d 795 at 799 (D.C.Cir. 1981). *See also Aaron* v. *Securities and Exchange Commission*, 446 U.S. 680, 100 S.Ct. 1945, 64 L.Ed.2d 611 (1980). Also entrenched in statutory interpretation is the principle that where a statute is not ambiguous, the party attempting to avoid its plain language must offer "persuasive reasons" for concluding that Congress did not mean what it said. *Higgins* v. *Marshall*, 584 F.2d 1035, 1037 (D.C.Cir. 1978), *cert. denied*, 441 U.S. 931, 99 S.Ct. 2051, 60 L.Ed.2d 659 (1979). *See Tennessee Valley Authority* v. *Hill*, 437 U.S. 153, 98 S.Ct. 2279, 57 L.Ed. 117 (1978). The plain meaning of a statute may be avoided where there has been a significant change of circumstances since enactment or when a literal reading leads to an unreasonable or absurd result. *Consumers Union of the United States, Inc.* v. *Heimann*, 589 F.2d 531, 534 (D.C.Cir. 1978).

What does a "plain" reading of the Glass-Steagall Act then reveal? Defendants cannot and do not seriously dispute that commercial paper is a "note or other security" as mentioned in Section 21. The parties agree that commercial paper consists of

short-term, negotiable, usually prime quality and unsecured notes. That under a strict reading of the Act, commercial paper would be covered by Section 21 is bolstered by the Court in *Investment Company Institute* v. *Camp*, 401 U.S. 617, 91 S.Ct. 1091, 28 L.Ed. 2d 367 (1971) (hereinafter *ICI I* or *Camp*) that "[t]here is nothing in the phrasing of either § 16 or § 21 that suggests the narrow reading of the word 'securities.' To the contrary, the breadth of the term is implicit in the fact that the antecedent statutory language encompasses not only equity securities but also securities representing debt." *Id.* at 635, 91 S.Ct. at 1101. Indeed, the statutes' unambiguous reference to "notes and *other* securities" surely indicates Congress's interpretation that the term "securities" encompassed "stocks, bonds, debentures and notes" in section 21. This meaning ascribed to section 21 applies with equal force to section 16, which does not mention "notes," but refers rather to "securities or stocks." *See Fortin* v. *Marshall*, 608 F.2d 525, 528 (1st Cir. 1979) (giving same words identical meanings in a single statute).

Does this strict interpretation of the Glass-Steagall Act lead to absurd and outrageous results? In the Board's view, many traditional commercial banking functions would simply grind to a halt were this Court to rule for plaintiffs, but their fears appear greatly exaggerated. Section 16 of the Glass-Steagall Act clearly recognizes that banks may discount and negotiate promissory notes as part of their traditional lending functions. Moreover, this Court is not presented with a broad-scale attempt by plaintiffs to reorganize the entire commercial banking industry. Rather, holding commercial paper to be included in the prohibition of the Glass-Steagall Act yields no great damage to the foundation of commercial banking. Whatever the Board decides to undertake as a result of the declaration herein is neither predicted nor directed, but when it recognizes that third-party commercial paper is a "note or other security," its mandate under the law will have been fulfilled.[9]

9 The Board decided that commercial paper was not an investment security and then swept to the conclusion that if the Court held that commercial paper was a note or security, banks would be completely

Reliance on the literal language of sections 16 and 21 is supported by the 1971 decision in *ICI I*. In *Board of Governors of the Federal Reserve System* v. *Investment Company Institute*, 450 U.S. 46, 101 S.Ct. 973, 67 L.Ed.2d 36 (1981) (hereinafter "*ICI II*") Mr. Justice Stevens described the *Camp* decision:

> In *Camp* the Court *relied squarely on the literal language of §§ 16 and 21 of the Glass-Steagall Act*. After noting that § 16 prohibited the underwriting by a national bank of any issue of securities and the purchase for its own account of shares of stock of any corporation, and that § 21 prohibited corporations from both receiving deposits and engaging in issuing, underwriting, selling, or distributing securities, *the Court recognized that the statutory language plainly applied* to a bank's sale of redeemable and transferable "units of participation" in a common investment fund operated by the bank.

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precluded from purchasing commercial paper. This, the Board contends, is an absurd result justifying rejection of the plain statutory language. The Board's contention that commercial paper is not an investment security, however, is not persuasive.

Section 16 grants to the Comptroller of the Currency the discretion to classify some securities as investment securities to permit banks to purchase them for their own account. The Comptroller's regulations specify that an investment security is "a marketable obligation in the form of a bond, note, or debenture which is commonly regarded as an investment security" that is not "predominately speculative in nature." 12 C.F.R. § 1.3(b). The Bank points to the legislative history of the McFadden Act of 1927 where Congressman McFadden clearly states that commercial paper was not considered an investment security. *See* 67 Cong. Rec. 3232 (1926). Plaintiffs indicate, however, that the McFadden Act was eviscerated by the Glass-Steagall Act in that Congress rejected the notion that commercial banks could be engaged in the investment banking business, a premise recognized by the McFadden Act. Additionally, plaintiffs submitted a letter from the Chief National Bank Examiner, dated March 10, 1981, in a matter unrelated to this dispute, where it is held that what is a loan for one purpose may be a security for another. Becker Reply Mem., Exh. 3. Banks could, even in light of the Court's holding, continue to purchase commercial paper as they traditionally have, and plaintiffs' arguments do not appear inconsistent with the scheme of the Glass-Steagall Act.

Id., 101 S.Ct. at 986 (emphasis added). See generally Clark and Saunders, *Judicial Interpretation of Glass Steagall: The Need for Legislative Action*, 97 Banking L.J. 721 (1980) (noting that courts traditionally invoke a literal interpretation of the Glass-Steagall Act).

The broad framework of the Glass-Steagall Act demonstrates that Congress intended to pass a flat prohibition against any single type of institution—commercial or investment banking—from engaging in any of the badges incident to the others' enterprise. The statute draws broad lines, leaving no room for administrative amendment. It reflects "the unalterable and emphatic intention of Congress to divorce commercial banks from the business of underwriting and dealing in securities." *Baker, Watts & Co.* v. *Saxon*, 261 F.Supp. 247, 252 (D.D.C. 1966), *aff'd sub nom. Port of New York Authority* v. *Baker, Watts & Co.*, 392 F.2d 497 (D.C. Cir. 1968). Deemed a "drastic step," the Glass-Steagall Act prohibits "commercial banks, banks that receive deposits subject to repayment, lend money, discount and negotiate promissory notes and the like, from going into the investment banking business." *ICI I*, 401 U.S. at 629, 91 S.Ct. at 1098. The Act "was a prophylactic measure directed against conditions that the experience of the 1920's showed to be great potentials for abuse." *Id.* at 639, 91 S.Ct. at 1103. The Court in *ICI I* further applied "as they were written" the Act's "literal terms" to overturn a decision of the Comptroller of the Currency to permit commercial banks to operate investment funds. *Id.*

This reading of the Glass-Steagall Act's framework is different from the Bank Holding Company Act of 1956, analyzed by the Supreme Court in *ICI II*. That statute authorizes the Board to determine whether a given activity is sufficiently related to banking to permit a nonbanking subsidiary of a bank holding company to engage therein. *See ICI II*, 450 U.S. at 73, 101 S.Ct. at 990. The Bank Holding Company Act clearly provides for the sort of discretionary decision made by the Board in this dispute, as it might be applied to a subsidiary of a bank holding company. But nowhere in the Glass-Steagall Act is the Board authorized, despite the plain language of the

statute, to permit a bank to engage in a particular activity because it does not pose risks to consumers or investors. Indeed, as the Court in *ICI I* recognized,

> From the perspective of competition, convenience, and expertise, there are arguments to be made in support of allowing commercial banks to enter the investment banking business. But Congress determined that the hazards [of that choice] made necessary to prohibit this activity to commercial banks.

ICI I, 401 U.S. at 636, 91 S.Ct. at 1101. Indeed, with the exception of the delegation in Comptroller of the Currency to determine what is an "investment security," there are no lines to be drawn.

The parties delve into the legislative history of the Glass-Steagall Act, neither producing convincing evidence of how Congress might have answered the question posed by this case were it presented in 1933. Nowhere in the record of the Act do the drafters define whether commercial paper is a note or other security. The defendants suggest that the Congress recognized that transactions in commercial paper were part of traditional banking practices at the time the Act was passed, and not part of the speculative business that gave rise to the prohibitions contained in the Act. Indeed, Senator Glass, whose name the Act bears, proposed during a debate on the Securities Act of 1933 that short term notes, including "nine months' commercial paper," be excluded from the definition of security contained in that legislation because such a definition would "radically interfere" with "ordinary commercial banking transactions." *Securities Act: Hearings on S. 875 before the Senate Committee on Banking and Currency*, 73d Cong., 1st Sess. 98 (1933). Plaintiffs counter that although banks were traditionally large purchasers of commercial paper, their role as seller was limited to occasional transactions; indeed, Congress's rejection of Senator Glass's proposal demonstrates a view that commercial paper was considered a security. It is unnecessary to trace the historical development of the commercial paper market; rather, based on the undisputed facts, the

role of Bankers Trust in its commercial paper transactions is an uncommon one for traditional banking institutions. Congress's silence as to commercial paper specifically, combined with the general scheme of the Act, indicates that it did not contemplate adjustments in the definition of "notes or other securities" by the Board or any other agency in an administrative proceeding.

The parties energetically dispute whether the definition of security in the Securities Act of 1933, which includes "any note," 15 U.S.C. § 77b(1), affects the interpretation of the Glass-Steagall Act. Although short term notes such as commercial paper are exempt from the registration provisions of the Securities Act of 1933, the antifraud proscriptions still apply. *See* 15 U.S.C. §§ 77c(a)(3), 77l(2). Defendants contend that the statutes have such different general purposes that it would be unreasonable to impute the definition of security offered in one statute to another act. *United Shoe Workers of America* v. *Bedell*, 506 F.2d 174, 188 (D.C.Cir.1974). Although the Securities Act of 1933 and the Glass-Steagall Act take regulatory aim at different financial institutions and markets, they were passed within three weeks of each other and designed to remedy the then existing catastrophe in the nation's financial markets. This is surely compelling evidence that the two statutes should be interpreted similarly. The district court, eventually affirmed in *ICI I* declared, "It would be inconsistent to conclude that Congress did not intend to obtain the equivalent meaning for the term 'securities' as used in the Securities Act of 1933 when it used the same term in the Glass-Steagall Act which was enacted by the same Congress." *Investment Company Institute* v. *Camp*, 274 F.Supp. 624, 642-43 (D.D.C.1967) (footnote omitted), *rev'd* 420 F.2d 83 (D.C.Cir. 1969), *rev'd* 401 U.S. 617, 91 S.Ct. 1091, 28 L.Ed.2d 367 (1971).

In an analogous decision, *United States* v. *American Building Maintenance Industries*, 422 U.S. 271, 95 S.Ct. 2150, 45 L.Ed.2d 177 (1975), the Supreme Court considered the phrase "in commerce" as it is used in the Federal Trade Commission Act and in the Clayton Act, and concluded that "since both sections were enacted by the 63d Congress, and both were

designed to deal with closely related aspects of the same problem—the protection of free and fair competition in the Nation's marketplaces," the statutes should be given similar interpretations. *Id.* at 277, 95 S.Ct. at 2155. Both the Glass-Steagall Act and the Securities Act were directed at curing the perceived rampant speculation by banks, securities dealers, and individuals prior to the Crash of 1929, such activity considered the chief cause of the Great Depression; their common goals suggest the relevance of the similar definitions.

The Board's final justification for its interpretation of the Glass-Steagall Act is its "functional analysis" of a commercial paper transaction which, in its view, compels the conclusion that commercial paper is more like a loan transaction than a security sale. The Board found that commercial paper, as short-term notes, functioned to provide corporations with cash and that banks, as traditional purchasers of commercial paper, effectively loaned such money to the issuers. *See* R. 682-84. The problem with the Board's analysis emerges instantaneously: it ignores the specific conduct of the bank, glossing over whether the bank purchases commercial paper for its own account, *e.g.*, its trust department, or purchases for future sale to an outside party or arranges a transaction between purchaser and seller. The Board's analysis would also sweep into its coverage almost all devices used by businesses to raise capital—including stocks and bonds—transforming transactions unquestionably at the heart of the securities industry into permissible activity for commercial depository banks. The dispute over the Board's determination that commercial paper represents a loan reveals the problematic query presented in this challenge: when is a device to raise funds for a business a loan and when is it a security? One factor present in this matter compels the conclusion that the commercial paper at issue here is not a loan, and that crucial aspect is the role of Bankers Trust in the transactions.[10]

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10 The Court, like the Board, does not reach the question whether Bankers Trust was actually underwriting securities in violation of the Glass-Steagall Act. The question presented herein is whether the Board

This dispute is only the proverbial tip of the iceberg as to debates currently raging in the houses of Congress concerning the proper functions of commercial banks, especially in light of a more active "banking" role taken by securities' dealers. In its *amicus* memoranda, the Securities and Exchange Commission argues forcefully and persuasively that any alteration of the lines drawn by current banking statutes is for the popularly-elected Congress to undertake. Especially in light of these current efforts to reallocate the roles of depository and non-depository institutions, both the Court and the Board should refrain from unique and heretofore unprecedented interpretations of the 1933 Glass-Steagall Act which cast such a long shadow as does the Board's ruling on the Becker and SIA petitions. The realignment of our nation's financial industries is for the elected representatives of our nation to bring to fruition by comprehensive legislation, and not for fiat by judicial decree or by administrative policymaking.[11]

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erred when it concluded that commercial paper was not a security under the Act. Although the Court has offered various characterizations to Bankers Trust's conduct, by no means does this opinion mean to convey that the bank was underwriting securities.

11 Becker contends that it was denied procedural due process by the Board in that the Board denied its request for a hearing or oral argument and refused to provide advance notice to Becker of the Board's meetings. The Court, in *Becker I* has already ruled on the open meeting aspect of the litigation, and Becker had no absolute right to present an oral argument. All of the written materials submitted were sufficient to permit the Board to deny oral argument without abusing its discretion. *Arthur Lipper Corp.* v. *Securities and Exchange Commission*, 547 F.2d 171, 182 n.8 (2d Cir. 1976), *cert denied*, 434 U.S. 1009, 98 S.Ct. 719, 54 L.Ed.2d 752 (1978). Becker also argues that the Board received *ex parte* communications from Bankers Trust while it was deliberating on the Becker and SIA petitions. The Board proffers an affidavit of Rose L. Arnold, in charge of the Freedom of Information Office for the Board, who indicates that the material received from Bankers Trust was available for inspection in the public reading room of the Board. Its availability to Becker and to the public negates Becker's contention that this material (now a part of the administrative record, *see* R. at 476-550) was concealed or that the Board's receipt of such documents prejudiced Becker's rights.

A word need be added about the exact nature of the relief to be awarded plaintiffs. As previously noted, the law prohibits any court from affecting the issuance of a cease and desist order under 12 U.S.C. § 1818. The plaintiffs have indicated that the principal relief sought is a declaratory judgment that the Board's September 26, 1980 ruling that commercial paper is not a note or security under the Glass-Steagall Act is contrary to law. Such a judgment is within the province of this Court to award, and is attached herein. The Court expresses no opinion as to what steps, if any, may be taken following the issuance of this declaratory judgment.

Federal Reserve System,
May 26, 1981

POLICY STATEMENT CONCERNING THE SALE OF THIRD PARTY COMMERCIAL PAPER BY STATE MEMBER BANKS

[Docket No. R-0360]

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Policy Statement

SUMMARY: Pursuant to its authority to restrain unsafe or unsound banking practices by State member banks, the Board of Governors of the Federal Reserve System adopts a policy statement setting forth guidelines governing the sale by a State member bank of commercial paper of issuers not related to the bank ("third party commercial paper"). The guidelines reflect the Board's judgment that certain practices may develop in the sale by a bank of third party commercial paper that may not be consistent with the principles of safe and sound banking. The guidelines concern the type and amount of commercial paper that should be sold, the kinds of records that should be maintained, and the purchasers to which such paper may be sold. The Board intends to monitor closely the activities of State member banks in this area and may modify or supplement this policy statement based on the Board's review of the experience of State member banks in conducting these activities.

EFFECTIVE DATE: May 26, 1981. Interested parties may submit comments on the policy statement that will be reviewed by the Board. Comments must be received on or before July 31, 1981.

ADDRESS: Comments should include reference to Docket No. R-0360 and should be mailed to the Secretary, Board of Governors of the Federal Reserve System, 20th and Constitution Avenue, N.W., Washington, D.C. 20551, or delivered to Room B-2223, 20th and Constitution Avenue, N.W., Washing-

ton, D.C. between 8:45 a.m. and 5:15 p.m. Comments may be inspected in Room B-1122 between 8:45 a.m. and 5:15 p.m.

FOR FURTHER INFORMATION CONTACT: Robert S. Plotkin, Assistant Director, Division of Banking Supervision and Regulation, (202) 452-2782, or Richard Ashton, Senior Counsel, Legal Division, (202) 452-3750, Board of Governors of the Federal Reserve System, Washington, D.C. 20551.

SUPPLEMENTAL INFORMATION: On September 26, 1980, the Board took action with respect to the petitions of the Securities Industry Association (the "SIA") and of A.G. Becker Incorporated ("A.G. Becker") that the Board prohibit Bankers Trust Company, New York, New York ("Bankers Trust"), a State member bank, from selling third party commercial paper. The Board denied the petitions to the extent they alleged that Bankers Trust's commercial paper activities violate the Glass-Steagall Act or should be prohibited by general considerations of public policy. The Board also stated that the sale of third party commercial paper by a commercial bank could involve, at least in some circumstances, potential unsafe or unsound practices. The Board thus took no action on the petitions' allegations of dangers to Bankers Trust or potential conflicts of interest pending development of general supervisory guidelines designed to avoid potential unsafe or unsound practices in the sale of third party commercial paper by State member banks.

In developing the guidelines that are set forth in the following policy statement, the Board has consulted with the staffs of the other federal banking agencies and has considered the allegations of unsafe practices made by the SIA and A.G. Becker and the comments of the Securities and Exchange Commission.

With respect to the possibility that a bank's commercial paper selling activities may lead the bank into investing its funds in imprudent investments, the Board recognizes that a bank's selling activity may result in the purchase of some commercial paper with the bank's own funds. However, the Board notes that banks have traditionally been permitted to purchase commercial paper for their own account and such

purchases have been treated for supervisory purposes as commercial loans. In addition, since only large, well-known corporations with established credit ratings are able to market unsecured obligations, commercial paper is generally a low-risk instrument, even relative to some commercial loans.[1] Furthermore, the Board's guidelines provide that a bank should sell only prime quality paper and make a thorough credit analysis of each issuer and that all commercial paper sold by the bank should be fully supported by available lines of credit.[2] These guidelines would also minimize the danger that a bank selling commercial paper might be tempted to make unsound loans to an issuer which is encountering financial difficulties in order to protect the bank's reputation.

The SIA, A.G. Becker, and the SEC have also raised the possibility of loans by a selling bank to facilitate purchase of commercial paper being sold by the bank. However, because rates on commercial paper are usually lower than rates charged on bank loans, the use of borrowed funds to purchase commercial paper would be unprofitable and thus unlikely. Accordingly, there does not appear to be any practical substance to this concern.

Another potential hazard cited in connection with bank sales of commercial paper is the possibility that the bank's salesman's interest might impair its existing obligations to its customers and might consequently damage the bank's good will and reputation. In particular, it is claimed that bank depositors might suffer losses on paper purchased from the bank, that "the bank's reputation for prudence and restraint would be abused," that the bank would lose its ability to provide disinterested investment advice, and that the bank

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1 The Board notes that, at least on some occasions, significant losses have been suffered by commercial paper purchasers, for example, the 1970 collapse of Penn Central Transportation Company. However, banking functions, such as commercial lending, also involve some degree of risk and losses can and do occur.

2 A selling bank could only participate in the line of credit up to the amount of its legal lending limit.

might "unload" worthless commercial paper in its trust department.

Under the Board's guidelines, however, a bank may sell commercial paper only to financially sophisticated purchasers and may not advertise commercial paper for sale to the general public. Thus, there appears to be little likelihood that any but a small fraction of a bank's depositors would even consider purchasing commercial paper being sold by the bank. For the same reason, the potential for a bank abusing its reputation for "prudence and restraint" in selling commercial paper does not appear significant. Finally, with respect to potential inability to provide disinterested investment advice and "unloading" of worthless commercial paper in the bank's trust accounts, the guidelines provide that the bank should not sell commercial paper to fiduciary accounts over which the bank has investment discretion.

The Board intends to monitor closely the selling activities of Bankers Trust and any other State member bank that may initiate such services. Based on further experience in this area, the Board may modify or supplement these guidelines to assure that such activities are conducted in accordance with principles of safe and sound banking.

Accordingly, acting pursuant to its supervisory authority over State member banks contained in section 9 (12 U.S.C. 321, *et seq.*) and section 11 (12 U.S.C. 248) of the Federal Reserve Act and the Financial Institutions Supervisory Act of 1966 (12 U.S.C. 1818(b)) and related provisions of law, the Board of Governors adopts the following policy statement.

POLICY STATEMENT CONCERNING SALE OF THIRD PARTY COMMERCIAL PAPER BY STATE MEMBER BANKS

The Board of Governors has recently determined that the sale of commercial paper by a State member bank for unaffiliated issuers ("third party commercial paper")[3] did not violate

3 Excluding commercial paper issued by a parent bank holding company; the Board has previously advised bank holding companies concerning sales of bank holding company commercial paper (letter dated June 27, 1980).

the Glass-Steagall Act (12 U.S.C. §§ 24, Seventh, 378). The Board was concerned however, that the sale of third party commercial paper[4] might, in some circumstances, involve unsafe or unsound practices. Accordingly, in the interest of safe and sound banking, the Board believes that any State member bank that may decide to engage in the sale of third party commercial paper should adhere to the following guidelines.[5]

1. A State member bank should sell only prime quality commercial paper that qualifies for the exemption provided by section 3(a)(3) of the Securities Act of 1933 (15 U.S.C. 77c(a)(3)). The bank should take appropriate precaution to assure itself that the section 3(a)(3) exemption applies to the commercial paper it proposes to sell. In this regard, (i) the bank should determine that the commercial paper it proposes to sell is of prime quality; (ii) the bank may rely on representations of the issuer with respect to the use of proceeds; (iii) except as further limited by paragraphs 7 and 8, the bank should sell commercial paper only to financially sophisticated customers, such as customers that regularly purchase a variety of short-term credit instruments, and should not advertise commercial paper for sale to the general public; (iv) the bank should obtain periodically, and maintain in the bank's records, a current legal opinion of counsel that the section 3(a)(3) exemption is available. In addition, the bank should sell commercial paper in minimum denominations that are consistent with applicable law and, in no event, should sell commercial paper in minimum denominations of less than $100,000.

2. The selling bank should maintain a complete credit analysis of the issuer at all times and should exercise due diligence

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4 Banks have traditionally purchased commercial paper upon the order, and for the account of, customers, whereas here the bank is essentially acting for the issuer; the former activity is not subject to the guidelines set forth in this Policy Statement.

5 The Board does not expect to take enforcement action to restrain unsafe or unsound banking practices with respect to third-party commercial paper selling activities of any State member bank that conducts such activities within these guidelines.

in investigating the financial affairs of the issuer. Particular attention should be given to the liquidity position of the issuer and its lines of credit. All commercial paper sold by the bank should be fully supported by available lines of credit. Any participation by the selling bank in such lines of credit should be made only after consideration of the bank's legal lending limit.

3. Senior management should adopt internal limits for the amount(s) of commercial paper that may be sold by the bank for a single or related issuer(s). In determining the internal limits, senior management should consider the financial condition of the issuer, all lines of credit available to the issuer, and the bank's participation in the lines of credit and any other extensions of credit or commitments to the issuer by the bank (including commercial paper purchased by the bank for its own account.)

4. Chronological records of original entry should be maintained that contain an itemized daily record of all sales and purchases of commercial paper. The records should also contain:

- A designation of the commercial paper,
- nature of the transaction, *e.g.* purchase or sale,
- trade and settlement dates,
- contra-party name or designation,
- net proceeds, discount rate, or yield to maturity.

5. Account records should be maintained for each issuer that reflect:

- All sales and purchases of commercial paper placed by the bank for that issuer,
- all lines of credit available to the issuer,
- the amount of the bank's participation in the lines of credit,
- a current balance of all extensions of credit and a description of other commitments to the issuer.

6. Account records should be maintained for each purchaser that reflect all sales and purchases of commercial paper for the account of that customer.

7. Commercial paper should not be sold to fiduciary accounts over which the bank has investment discretion.

8. Commercial paper should not be sold to the bank's parent holding company (unless it is a bank) or any nonbank affiliate of the bank.

9. The bank should furnish to all purchasers of commercial paper written advice in connection with all purchases that (1) the commercial paper is not an obligation of the bank, and is not insured by the FDIC, (2) the bank has no obligation to repurchase any of the paper sold, (3) the bank is under no obligation to lend funds to the issuer (except pursuant to existing credit lines, or other commitments, if any), and (4) copies of the issuer's most recently published financial statements will be furnished upon request.

By order of the Board of Governors, May 26, 1981.

/s/ James McAfee

JAMES MCAFEE
Assistant Secretary of the Board

(SEAL)

Federal Reserve System,
September 26, 1980

STATEMENT REGARDING PETITIONS
TO INITIATE ENFORCEMENT ACTION

The Securities Industry Association (the "SIA") and A.G. Becker, Incorporated ("A.G. Becker") have requested the Board to prohibit Bankers Trust Company, New York, New York ("Bankers Trust"), a State member bank, from selling commercial paper issued by companies not related to the bank ("third party commercial paper"). The SIA and A.G. Becker allege that Bankers Trust's sale of third party commercial paper violates the Glass-Steagall Act, which generally prohibits banks from underwriting or dealing in securities. A.G. Becker also contends that considerations of public policy militate against permitting Bankers Trust from selling third party commercial paper.

Bankers Trusts' Sales Activities

Commercial paper refers to prime quality, negotiable, usually unsecured short-term promissory notes issued by business organizations to meet part of their short-term credit needs.[1] Commercial paper is offered and sold to sophisticated purchasers, rather than to the general public, through dealers or directly by the issuer. Because commercial paper is usually unsecured, issuers are generally large, well-known, and financially strong businesses. Most commercial paper has an initial maturity of 60 days or less and the paper sold by dealers is issued in denominations usually ranging from $100,000 to $1 million or more. Purchasers of commercial paper are mostly large institutions with idle short-term funds to invest. Commercial paper is considered relatively risk-free; interest rates on

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1 For a more detailed description of the commercial paper market *see* Hurley, The Commercial Paper Market, 63 Fed. Res. Bull. 525 (1977) [hereinafter cited as "Hurley"] and Comment, *The Commercial Paper Market and the Securities Acts*, 39 U. Chi. L. Rev. 362 (1972).

commercial paper are usually slightly above the rates on short-term United States government obligations, such as Treasury bills. The proceeds of commercial paper traditionally have been used for current or seasonal needs.

Bankers Trust represents that it is selling third party commercial paper only as the agent of the issuer and that the bank is not, like the commercial paper dealers, acting as a principal in such sales. Bankers Trust does not purchase, or make any commitment to purchase, the commercial paper the bank sells as agent. On some occasions, however, Bankers Trust extends credit (without any prior commitment), at or near the commercial paper rate, to issuers of paper sold by the bank in an amount representing a small portion of the unsold amount of the issue. The notes representing such loans may subsequently be sold. The bank's parent holding company has purchased for its own account commercial paper sold by the bank.[2]

Bankers Trust states that it does not tie the use of its other services to its commercial paper selling services and does not offer special inducements to issuers using such services. Bankers Trust sells only prime quality commercial paper of issuers that have the highest rating from at least one of the rating services that rate commercial paper issuers.

The customers to whom Bankers Trust sells commercial paper are usually part of Bankers Trust's established base of institutional investors that regularly purchase from the bank other short-term instruments in which the bank deals. Bankers Trust does not sell to individuals or to its trust department accounts.

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2 The bank also provides financial advice to issuers with regard to the issuance of commercial paper and serves as settlement agent for purchases of commercial paper. None of these activities has been directly challenged. Bankers Trust also sells as agent commercial paper issued by its own parent holding company. The Legal Division's analysis expressed no opinion on this activity and it is not involved in the present petitions.

The Glass-Steagall Act Issues

The Banking Act of 1933 contains four provisions (collectively referred to as the Glass-Steagall Act) that restrict participation by banks and affiliates of banks in specified securities activities. The provisions involved here are sections 16 and 21 of the Act, the provisions that apply to banks.[3] Section 16 provides in relevant part:

> The business of dealing in securities and stock by the [national bank] shall be limited to purchasing and selling such securities and stock without recourse, solely upon the order, and for the account of customers, and in no case for its own account, and the association shall not underwrite any issue of securities or stock. 12 U.S.C. § 24 Seventh.

Section 5(c) of the Glass-Steagall Act, 12 U.S.C. § 335, provides that State member banks are subject to the limitations of section 16 with respect to dealing in securities.

Section 16 carves out an exception to the general prohibition against involvement with securities by providing that national banks (and consequently State member banks) may purchase for their own account "investment securities" as defined in the statute.[4] "Investment securities" are defined by section 16 generally as marketable debt obligations commonly known as investment securities under such further definition prescribed by the Comptroller of the Currency. The Comptroller's regula-

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3 Section 20 of the Act, 12 U.S.C. § 377, prohibits affiliates of banks from "engaging principally in the issue, flotation, underwriting, public sale or distribution" of securities. In addition, section 32 of the Act prohibits member banks from having director, officer, or employee interlocks with companies "primarily engaged" in the securities business.

4 Section 16 makes a further distinction with respect to investment securities. Banks may *underwrite* and *deal in* (as well as purchase for their own account) certain kinds of investment securities: obligations of the United States, general obligations of states or political subdivisions of states, and obligations of or guaranteed by certain government agencies.

tion, 12 C.F.R. § 1.3(b), defines "investment security" as a marketable debt obligation "commonly regarded as an investment security" and not "predominantly speculative in nature."

Section 21 of the Glass-Steagall Act provides that it is unlawful

> For any person, or . . . organization, engaged in the business of issuing, underwriting, selling, or distributing, . . . stocks, bonds, debentures, notes, or other securities, to engage at the same time . . . in the business of receiving deposits. 12 U.S.C. § 378(a)(1).

Section 21 further provides that its restrictions do not prohibit any bank from "dealing in, underwriting, purchasing, and selling investment securities, or issuing securities" to the extent such activities are permissible under section 16.

Thus, both section 16 and section 21 recognize a distinction between "investment securities" and other kinds of securities. Banks in general may invest in, *but not* underwrite or deal in (with limited exceptions), investment securities; banks are barred from issuing, purchasing for their own account, underwriting, or dealing in securities that do not qualify as investment securities.[5]

The contentions of the SIA and A.G. Becker that Bankers Trust is violating these statutory prescriptions are based on the contentions that (1) commercial paper is a "security" for purposes of the Glass-Steagall Act and (2) Bankers Trust's selling activities constitute the forbidden underwriting and dealing in securities. Additionally, the SIA and A.G. Becker claim that the selling of third party commercial paper gives rise to the kinds of abuses and hazards identified in the Supreme Court's 1971 analysis of the Act in *Investment Company Institute* v. *Camp*, 401 U.S. 617. The Securities and Exchange Commission ("SEC") has submitted to the Board the SEC's views on the issues raised by petitioners.

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5 Under section 16, however, banks may perform certain *brokerage* activities—purchase or sale solely on the order of a customer—with respect to any securities.

A. *Commercial Paper as a "Security" under the Glass-Steagall Act*

The SIA, A.G. Becker, and the SEC advance three arguments in support of the claim that the commercial paper being sold by Bankers Trust is a "security" within the meaning of the Glass-Steagall Act: (1) commercial paper consists of marketable debt instruments and therefore constitutes an "investment security" as defined in section 16; (2) even if commercial paper is not an "investment security", commercial paper is a security because it consists of "notes" as specified in section 21; (3) commercial paper is a security for purposes of the Securities Act of 1933 and accordingly must be considered such for purposes of the Glass-Steagall Act, which was passed twenty days after the Securities Act.

Based on a review of all the relevant arguments and the facts of record, the Board is of the opinion that, as a legal matter, the stronger argument is that commercial paper is not a "security" within the intendment of the Glass-Steagall Act.

"*Investment securities*." In interpreting the meaning of the Glass-Steagall Act, the starting point must be the language of the statute itself.[6] Although each of the four Glass-Steagall Act provisions refers to activities with regard to "securities," none of these provisions, nor any other section of that Act, contains a precise definition of the term "securities." As noted above, however, both section 16 and section 21 create a distinction between investment securities—obligations that a member bank may purchase for its own account but in general may neither underwrite nor deal in—and other securities—obligations with which banks may have no involvement (except for permissible brokerage activities).

"Investment securities" are defined in section 16 as follows:

> *marketable obligations, evidencing indebtedness* of any person, copartnership, association, or corporation in the form of bonds, notes and/or debentures *commonly*

6 *See, e.g., Transamerica Mortgage Advisers, Inc. v. Lewis*, 444 U.S. 11, 16 (1979).

> *known as investment securities under such further definition* of the *term . . . as may by regulation be prescribed by the Comptroller of the Currency.* 12 U.S.C. § 24 Seventh (emphasis added).

The Comptroller's implementing regulation defines investment security as "a marketable obligation in the form of a bond, note, or debenture *which is commonly regarded as an investment security*" that is not "predominantly speculative in nature." 12 C.F.R. § 1.3(b). (emphasis added).

The statutory language and the implementing regulation are clear: not all non-speculative, marketable debt obligations are "investment securities"; only those obligations that are *commonly known* or *regarded* as such qualify.[7] Consequently, the statute directs that the question of whether commercial paper constitutes an investment security be resolved only by resort to the common understanding of the nature of commercial paper by Congress, the regulatory agencies, and the banking industry.

The "investment securities" provision in section 16 did not originate in the Glass-Steagall Act, but in the prior provisions of the McFadden Act of 1927.[8] One of the purposes of the McFadden Act was to clarify the authority of national banks to deal in securities. At the beginning of this century, State chartered banks and trust companies, pursuant to liberal State legislation, became involved in a wide variety of investment banking functions, including the underwriting of debt and equity securities. National banks responded by expanding their activities to include the purchasing and selling—and underwriting and dealing in—not only municipal bonds but corporate bonds and stocks as well. *See* U.S. Department of the Treasury, Public Policy Aspects of Bank Securities Activities, App. 3-5 (1975). While the Comptroller permitted national banks to deal

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7 The contentions of the SIA and A.G. Becker that commercial paper is an investment security *merely* because such paper consists of marketable debt obligations ignore this plain language of the statute and the implementing regulation.

8 Pub. L. No. 639, ch. 191, 44 Stat. 1224.

in corporate debt,[9] there was no clear statutory authority for such activities. *Id.* In 1924, the Comptroller recommended legislation expressly to authorize national bank purchase and sale of investment securities.[10] The McFadden legislation followed in 1927.

Section 2 of that Act provided that the "business of buying and selling investment securities shall hereafter be limited to buying and selling without recourse" marketable debt obligations commonly known as investment securities.[11] 44 Stat. 1226. This language was intentionally framed as a reaffirmance of the existing authority of national banks with respect to investment securities rather than as an affirmative grant of new power. *See* H.R. Rep. No. 83, 69th Cong., 1st Sess. 3-4 (1926). The legislative history, however, is clear that the authority codified or confirmed by the McFadden legislation with respect to investment securities did not apply to commercial paper. This is made plain by the remarks of Congressman McFadden, the sponsor of the legislation, during debate on the bill. Mr. McFadden indicated that commercial paper is not considered an investment security (and thus would not be subject to the restrictions of the Act) but is subject to the statutory limitations on loans to individual borrowers. 67 Cong. Rec. 3232 (1926).[12]

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9 The Comptroller, as well as the courts, strictly forbade, however, national bank involvement in underwriting and dealing in equity securities. *Id.*, at 2-3, 5.

10 Annual Report of the Comptroller of the Currency for 1924, at 12.

11 This power was, of course, later restricted somewhat by the Glass-Steagall legislation.

12 The relevant colloquy involving Congressman McFadden is as follows:

> Mr. WAINRIGHT. Let me ask the gentleman whether *commercial paper, as generally understood and accepted*, is regarded as *investment security*.
>
> Mr. McFADDEN. *No; it is not*. Commercial paper comes under the limitation of section 5200 in the Revised Statutes. I never have known of commercial paper being construed as investment securities. *Id.* (emphasis added).

The view of the framers of the McFadden Act that commercial paper should be treated as a loan rather than as a security is consistent with historical studies of the commercial paper market that indicate that banks purchased and sold commercial paper (and served as commercial paper dealers) pursuant to their lending functions long before commercial banks began expanding their activities into the underwriting of corporate bonds and other debt obligations after the Civil War, activities that were restricted by the McFadden legislation concerning investment securities and, six years later, by the Glass-Steagall Act. Thus, the commercial paper activities of commercial banks were viewed as an independent operation separate from the banking industry's subsequent involvement with investment securities.[13]

Furthermore, it has been the consistent and uniform practice of the bank regulatory agencies for almost 50 years to consider commercial paper as a loan, not as an investment security. For example, the Board took the view in 1933, in letters to the House Commerce Committee and the Senate Banking Committee commenting on the proposed securities legislation of

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13 *See generally* A. Greef, The Commercial Paper House in the United States (1938) [hereinafter cited as "Greef"]; N. Baxter, The Commercial-Paper Market (1964); M. Myers, The New York Money Market, Vol. I (1932). Greef found, for example, that before 1840 commercial banks in various parts of the country were purchasing and selling commercial paper and that dealings by banks in commercial paper could be traced back to the first commercial banks organized in the United States. Greef, *supra*, at 6-7, 15-18. Indeed, by 1900 commercial banks and savings banks purchased 95 per cent of the commercial paper sold, *id.*, at 96, and commercial paper was recognized as an important form of secondary reserves for the banking system. B. Beckhart, The New York Money Market, Vol. III 236-242 (1932). In addition to purchasing commercial paper as an investment, banks participated in the selling of such paper as dealers. Greef, *supra*, at 63, 403-405; R. Foulke, The Commercial Paper Market 108 (1931). In light of the longstanding and intimate relationship of banks with commercial paper, the views of the framer of the investment security legislation that commercial paper was not subject to its provisions are consistent with common banking practice at the time.

1933, that commercial paper, "short-time paper issued for . . . obtaining funds for current transactions" and purchased by banks and corporations with temporarily idle funds should not be considered an investment security. The Board stated that the proposed legislation was apparently intended to apply only to "investment securities, which are issued for . . . obtaining capital funds . . . and are purchased by persons for investment."[14]

Although the Comptroller of the Currency is delegated primary responsibility for fashioning a definition of the term, the Comptroller has never formally ruled on the status of commercial paper as an investment security for purposes of section 16. However, in a letter to a national bank in 1971, the Comptroller's Chief Counsel took the position that commercial paper represents a loan (subject to the statutory limits on loans) and does not constitute an investment security.[15]

The present attitude of the bank regulatory agencies is consistent with the view that commercial paper is properly viewed as a loan, not as an investment security. The instructions of each of the three federal banking agencies for preparation of call reports direct that commercial paper be treated as a loan. In addition, the Federal Reserve's manual of examination procedures follows the same position. In sum, based on the views of the framers of the investment securities provisions of section 16, of the banking industry, and of the regulators, the Board believes that commercial paper has not been, and is

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14 The Board's letters are reprinted in the hearings on the securities legislation. *Federal Securities Act: Hearing on H.R. 4313 before the House Comm. on Interstate and Foreign Commerce*, 73d Cong., 1st Sess. 180-181 (1933); *Securities Act: Hearings on S. 875 before the Senate Comm. on Banking and Currency*, 73d Cong., 1st Sess. 120 (1933).

15 Under an interpretation issued by the Comptroller, the statutory limits on loans to individual borrowers (12 U.S.C. § 84) are separate and distinct from the limit prescribed by section 16 of the Glass-Steagall Act on holding investment securities of a single issuer. 12 C.F.R. § 7.1180.

not, "commonly known" as an "investment security" and thus does not meet the statutory criteria for investment securities under section 16.

"Securities" other than "investment securities." Apart from the restrictions applicable to investment securities, sections 16 and 21 impose prohibitions with respect to securities in general. Section 16 generally prohibits dealing in "securities and stock." Section 21 states that depository institutions may not engage in the business of issuing or selling "stock, bonds, debentures, *notes* or other securities." (emphasis added). Since commercial paper conventionally consists of unsecured promissory notes, it may be argued that the term "notes" as used in section 21 is, under its usual meaning, broad enough to cover commercial paper. While the words in statutes should generally be interpreted in light of their ordinary meaning,[16] it is clear for a number of reasons that the term "notes" as used in section 21 should not be interpreted according to its literal sense. First, by its terms section 21 describes depository institutions (institutions that section 21 prohibits from issuing and selling "notes") as engaged in the business of receiving deposits evidenced by a "certificate of deposit or other evidence of debt"—instruments that themselves may be classified as "notes." Thus section 21 itself expressly permits banks to issue and sell certain kinds of notes—notes evidencing deposits. Second, the Glass-Steagall Act was plainly designed to keep banks from engaging in the investment banking business, not to prohibit banks from performing the traditional functions of banks.[17] Ordinary lending transactions are evidenced by notes

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16 *See, e.g., Perrin* v. *United States*, 444 U.S. 37, 42 (1979).

17 *See Investment Company Institute* v. *Camp*, 401 U.S. 617, 629 (1971) [hereinafter cited as "*ICI* v. *Camp*"]. Indeed the Supreme Court in the *Camp* case noted that commercial banks traditionally ". . . lend money, discount and negotiate promissory *notes* . . ." *Id.* (emphasis added). Indeed, if commercial paper were deemed to be a security other than an investment security, banks would be prohibited even from purchases of commercial paper for their own account, an activity that banks have long engaged in and continue to conduct. *See* Greef, *supra* note 13, at 96; Hurley, *supra* note 1, at 529.

issues. *ICI* v. *Camp*, *supra* note 17, 401 U.S. at 629-630, 632.[19] The Glass-Steagall bill was enacted only after extensive hearings on its provisions had been held in 1931 and 1932. Neither the Board nor the parties have been able to find any evidence of congressional concern about bank involvement with commercial paper. Morevoer, because at the time that the Glass-Steagall Act was being considered commercial banks purchased for their own account almost all of the commercial paper issued and commercial paper served as an important source of secondary reserves,[20] it may well be doubted that Congress could have been unaware of the extensive relationship then existing between the banking system and the commercial paper market.

Moreover, while there is no direct evidence in the legislative history of the Glass-Steagall Act on the status of commercial paper under the Act, there is evidence of contemporaneous statements by one of the draftsmen of the Act that commercial paper should not be considered a security. While the Glass-Steagall Act was pending before Congress in 1933, Congress was also considering the legislation that became the Securities Act of 1933. During Senate consideration of the securities bill, Senator Glass, the chief architect of the prohibitions against bank securities activities, proposed that short-term notes, including "9 months' commercial paper," be excluded from the definition of securities contained in that bill because to define such obligations as securities would "radically interfere" with "ordinary commercial banking transactions."[21] While Senator

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19 *See also Russell* v. *Continental Illinois National Bank & Trust Co.*, 479 F.2d 131 (7th Cir.), *cert. denied*, 414 U.S. 1040 (1973); *Baker, Watts & Co.* v. *Saxon*, 261 F. Supp. 247 (D.D.C. 1966), *aff'd sub nom. Port of New York Authority* v. *Baker, Watts & Co.*, 392 F.2d 497 (D.C. Cir. 1968); *New York Stock Exchange, Inc.* v. *Smith*, 404 F. Supp. 1091 (D.D.C. 1975), *rev'd on other grounds*, 562 F.2d 736 (D.C. Cir. 1977), *cert. denied*, 435 U.S. 942 (1978).

20 *See* note 13 *supra*.

21 *Securities Act: Hearings on S. 875 before the Senate Comm. on Banking and Currency*, 73d Cong., 1st Sess. 98 (1933).

and, in addition, banks commonly sell such notes to other lenders. It is evident that to view a note representing a bank loan as a security for Glass-Steagall Act purposes and, thus, the sale of such notes as an investment banking activity forbidden by the Act is completely at odds with the basic purpose of the Act. The rules of statutory interpretation do not require a literal reading of the term "notes" that would thwart the clear purpose of the Act and that leads to irrational results.[18]

Since the plain meaning of the statute cannot be dispositive of whether commercial paper is a security under the Glass-Steagall Act, it is appropriate to examine the history of the Act to attempt to resolve the question. It appears that Congress never adverted to bank involvement with commercial paper when it considered the Glass-Steagall legislation. There is, however, some indirect evidence that Congress did not view commercial paper, at least as the commercial paper market then existed, as the kind of obligation that would be subject to the Act. It is commonly agreed that the Glass-Steagall Act resulted from a number of specific abusive practices with respect to securities that had grown up in the banking industry. In particular, Congress was concerned about the risks and dangers to the banking system resulting from bank involvement with the "speculative operations" in securities characteristic of investment banking and with the practice of banks, begun in 1908, of establishing "security affiliates" that engaged, among other things, in underwriting bond and stock

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18 *See, e.g., Trans Alaska Pipeline Rate Cases*, 436 U.S. 631, 643 (1978). This approach has been taken by the courts in interpreting the definition of security in the securities acts, which generally define "security" to include "any note." The courts have not applied this language literally to bring all notes within the ambit of the securities laws but, on a variety of theories, have for the most part concluded that notes evidencing traditional lending transactions are not covered. *Exchange National Bank of Chicago* v. *Touche, Ross & Co.*, 544 F.2d 1126, 1131-1138 (2d Cir. 1976). *See generally United Housing Foundations, Inc.* v. *Forman*, 421 U.S. 837, 848-850 (1975).

Glass's proposed amendment was eventually adopted only as an exemption from some of the substantive provisions of the Securities Act,[22] his statements concerning the need for such an amendment strongly suggest that one of the principal draftsmen of the Glass-Steagall Act viewed commercial paper as closely linked to "ordinary commercial banking transactions" and not as involving the speculative investment banking functions that the legislation he sponsored was intended to restrain.[23]

In the course of administering the Glass-Steagall Act over the years the Board has not applied the Glass-Steagall Act prohibitions to the activities of banking organizations with respect to commercial paper. As noted above in the discussion of investment securities, the Board has traditionally viewed commercial paper purchased for a bank's own account as a loan, not as a security, for purposes of call reports. Furthermore, in its 1973 interpretation of the Glass-Steagall Act with respect to the sale of thrift notes (small denomination unsecured notes sold more or less continuously) by bank holding companies, the Board, while not expressly finding that commercial paper is not a security, stated that the issuance of commercial paper by a bank holding company "is not an activity intended to be included within the scope of section 20 of the Glass-Steagall Act." 12 C.F.R. § 250.221.

In addition to a review of the legislative history and agency interpretation, it is also appropriate to consider the status of commercial paper under the Act in light of the purposes for

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22 The effect of this action by Congress is discussed below.

23 The SEC argues that the testimony of Senator Glass is not persuasive because the Securities Act was enacted *before* the Glass-Steagall Act. Thus, according to the SEC, Senator Glass, if he really believed commercial paper was not a security, would have attempted, after a broad definition of "security" was adopted in the Securities Act, to amend the Glass-Steagall Act to exclude commercial paper. However, this argument assumes, without any support, that Senator Glass viewed the Securities Act definitions as germane to the Glass-Steagall Act.

which the Act was passed—to separate commercial and investment banking. As noted above with respect to the definition of "notes", a broad generic or literal reading of the term "security" would likely encompass a number of instruments that banks routinely deal with in the course of their business and would, consequently, be contrary to the basic purpose of the Act. On the other hand, a highly technical or formalistic approach might permit evasions of the mandate of Congress. However, it would seem that if a particular kind of financial instrument evidences a transaction that is more functionally similar to a traditional commercial banking operation than to an investment transaction, then fidelity to the purposes of the Act would dictate that the instrument should not be viewed as a security.

If such an approach is taken with respect to commercial paper, the Board believes that the stronger conclusion is that commercial paper currently being sold by Bankers Trust represents a financing transaction that is closer in function to commercial lending than to the sale of an investment. Historically, the dividing line between commercial and investment banking depended on whether short-term or long-term funds were being provided. As a short-term instrument, commercial paper fell on the commercial banking side of the line. Historical studies of the commercial paper market indicate that, as that market originated and developed, commercial paper was the functional equivalent of a bank loan. Commercial paper was used to raise funds for short-term needs and was sold almost exclusively to commercial banks.

It is clear, however, that the commercial paper market has changed somewhat in recent years. Most notably, commercial banks are no longer the predominant purchasers of commercial paper.[24] Nevertheless, the Board is of the opinion that, after a review of Bankers Trust's activities, the commercial paper currently being sold by the bank appears to evidence transactions that are more like commercial lending transactions than the sale of investments. First, the commercial paper sold

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24 *E.g.*, Hurley, *supra* note 1, at 529.

by Bankers Trust, like commercial paper generally, is a short-term instrument. While it may no longer be said that the provision of short-term credit to business is exclusively the function of banks, short-term loans continue to be the principal activity of commercial banks.[25] In addition, a typical commercial loan transaction involves a borrower and a single lender or, in the case of a loan participation, a relatively small number of lenders, that regularly extend credit as part of a business. Likewise, the purchasers of the commercial paper sold by Bankers Trust are relatively few in number and purchase paper in denominations larger than an average investor might be expected to afford. Moreover, it appears that most of the purchasers of the paper are part of the bank's base of institutional customers that purchase short-term obligations on a regular basis. These facts, in the Board's view, support the conclusion that the commercial paper currently being sold by Bankers Trust is more analogous to a commercial loan than to an investment. This view is consistent with the legislative history of the Glass-Steagall Act and the Board's general approach to commercial bank involvement with commercial paper. Accordingly, the Board believes that the stronger argument is that commercial paper should not be considered a security for the purposes of the Glass-Steagall Act.[26]

The Securities Act of 1933. The SIA, A.G. Becker, and the SEC argue that because commercial paper is a security for purposes of the Securities Act of 1933,[27] commercial paper

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25 While it is the practice of commercial paper issuers to reissue (roll over) paper at maturity, the purchasers of the paper, unlike the holders of bonds or other longer term instruments, have the legal right to demand payment at the original maturity date.

26 The Board's conclusion is limited to the obligations generally recognized as commercial paper: prime quality, negotiable, usually unsecured, promissory notes with maturities less than nine months that are exempt from the registration requirements of the Securities Act of 1933. The Board expresses no opinion with regard to the sale by a bank of third party obligations that do not meet these criteria.

27 Act of May 27, 1933, ch. 38, 48 Stat. 74.

must likewise be viewed as a "security" under the Glass-Steagall Act. Under section 2(1) of the Securities Act, 15 U.S.C. § 77b(1), the term "security" includes "any note." Section 3(a)(3) of that Act exempts from the registration and prospectus-delivery requirements of the Act any note the proceeds of which are used for current transactions and with a maturity of nine months or less. 15 U.S.C. § 77c(a)(3). Under sections 12(2) and 17(c), 15 U.S.C. §§ 77l(2), 77q(c), such short-term notes are not exempt from the antifraud prohibitions of that Act. Consequently, it is generally held that commercial paper is a security (albeit an exempt security) for purposes of the Securities Act.[28] The petitioners and the SEC contend that the Securities Act definition of "security" should be read into the Glass-Steagall Act because the two pieces of legislation address the same activities and were enacted within three weeks of each other in 1933.[29]

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28 *Franklin Savings Bank* v. *Levy*, 551 F.2d 521, 524 n.6 (2d Cir. 1977). With respect to the status of commercial paper under the other major federal securities law, the Securities Exchange Act, the question is not as clear. Unlike the 1933 Act, the 1934 Act expressly exempts commercial paper from that Act's *definition* of security. 15 U.S.C. § 78c(a)(10). The courts have not applied the exclusion literally, and courts have found that commercial paper is covered under the 1934 Act, at least where the particular commercial paper involved did not meet the criteria for exemption from registration under the 1933 Act, *e.g.*, the commercial paper was sold to the public. *Sanders* v. *John Nuveen & Co.*, 463 F.2d 1075, 1078-1080 (7th Cir.), *cert. denied*, 409 U.S. 1009 (1972).

29 Petitioners and the SEC rely on the legal analysis contained in a 1977 Board staff study of commercial bank private placements, which concluded that the definitions of "issue", "underwriter", and "distribution" in the Securities Act were "a compelling analogy" to the same terms employed in the Glass-Steagall Act. The Board has never formally reviewed the legal conclusions of the staff's private placement study. However, the private placement legal analysis does not necessarily contradict the position taken here. The private placement conclusions do not suggest that the definitions of the Securities Act are *conclusive*. In addition, the Board believes there is a distinction between definitions of activities carried on in the securities business and the definitions of a security, which are jurisdictional in nature and more closely linked to the purposes for which each Act was enacted.

While it seems clear that the definition of security in the Securities Act is relevant to a determination with regard to what instruments Congress thought were securities covered by the Glass-Steagall Act, it is the Board's opinion that the definition of security in the federal securities laws cannot be deemed conclusive for Glass-Steagall Act purposes. In the Board's view, this conclusion is supported by a number of arguments, but the most persuasive argument is that the definition of security under the Securities Act encompasses a variety of instruments that represent traditional banking functions and that to apply the prohibitions of the Glass-Steagall Act to such obligations would make illegal functions that clearly are properly part of the business of banking.[30] For example, a bankers' acceptance, like commercial paper, is a security under the Securities Act but exempt from registration. 15 U.S.C. §§ 77b(1), 77c(a)(3). However, commercial banks routinely purchase and sell bankers' acceptances and commercial banks (including Bankers Trust) serve as dealers in bankers' acceptances. Indeed, the Board determined as long ago as 1934 that bankers' acceptances were *not* securities under the Glass-Steagall Act.[31] To view the Securities Act definition of security as conclusive for Glass-Steagall purposes, as the securities industry representatives and the SEC suggest, would require that the traditional activities of commercial banks regarding bankers' acceptances be considered as the prohibited dealing in securities. This result is clearly contrary to the intent of the Glass-Steagall Act, which was not intended to restrict commercial banking functions. *ICI* v. *Camp*, *supra* note 17, at 629. In addition, although the courts are not unanimous, the

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30 It should also be noted that the Securities Act and the Glass-Steagall Act were not enacted to accomplish the same objectives. The Securities Act is an *investor* protection measure; the Glass-Steagall act is designed to protect *banks*, not investors. *Russell* v. *Continental Illinois National Bank & Trust Co., supra,* note 19.

31 Letter, dated June 8, 1934, from the Secretary of the Board to the Federal Reserve Agent, Federal Reserve Bank of New York.

securities laws have in some cases been held applicable to certificates of deposits issued by banks,[32] passbook savings accounts,[33] loan participations,[34] and bills of exchange.[35] Under the theory advanced by the SIA, A.G. Becker, and the SEC, banks would be prohibited from issuing,[36] selling, or dealing in each of these instruments on the grounds that doing so is the prohibited business of investment banking. The Board does not believe such contentions are consistent with the purpose of the Act.[37]

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32 *Garner* v. *Pearson,* 374 F. Supp. 591, 596 (M.D. Fla. 1974).

33 *SEC* v. *First American Bank & Trust Co.*, 481 F.2d 673, 678 (8th Cir. 1973).

34 *Lehigh Valley Trust Co.* v. *Central National Bank of Jacksonville,* 409 F.2d 989, 991-992 (5th Cir. 1969).

35 *MacAndrew & Forbes Co.* v. *American Barmag Corp.*, [1972-1973 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 93,532 (D.S.C. 1972).

36 The SEC states that considering time deposits as securities under the Glass-Steagall Act would not disrupt the statutory scheme of that Act because the Act does not prohibit a bank from issuing its *own* securities—only dealing in or underwriting the securities issued by *others.* However, section 21 plainly prohibits banks from engaging in the business of "issuing" and "selling" securities and does not limit such securities to those of third parties. While Board staff has taken the position that a bank's occasional issuance of its own stock, bonds, or debentures (an activity essential to the viability of the organization) does not constitute being engaged "in the business" of issuing securities under section 21, it seems clear that banks issue and sell time deposits, bankers' acceptances, and similar instruments as a regular part of their "business" and, if such instruments are considered securities for Glass-Steagall Act purposes, banks would be prohibited by the Act from such activities.

37 The Board expresses no opinion regarding the legal status of the commercial paper sold by Bankers Trust under the Securities Act of 1933 or under any other law except the Glass-Steagall Act. It is noted, however, that commercial paper has been held to be a security for at least some purposes under the federal securities laws. *See* pages 20-21, *supra.*

Because of the historical involvement of the banking industry with commercial paper, the nature of the commercial paper currently sold by Bankers Trust, and the fact that commercial paper is exempt from the substantive obligations of the Securities Act of 1933 (except for the antifraud provisions), the Board concludes that, notwithstanding the status of commercial paper as an exempt security under the Securities Act, the stronger argument is that commercial paper is not a security for purposes of the Glass-Steagall Act.

B. *Bankers Trust's Activities as Dealing in or Underwriting Securities*

Since, in the Board's opinion, the stronger argument is that commercial paper should not be treated as a security covered by the Glass-Steagall Act, the restrictions of the Act with regard to issuing, underwriting, selling, and dealing in securities do not apply. Thus, it is not necessary to reach the issue of whether the activities engaged in by Bankers Trust are prohibited by the Act.

C. *Policy Concerns Behind the Glass-Steagall Act*

The SIA, A.G. Becker, and the SEC also assert that the selling of commercial paper by Bankers Trust produces the same kinds of risks to the bank and potential for conflicts of interest that Congress intended to eliminate in enacting the Glass-Steagall Act. In its opinion on the Glass-Steagall Act in *ICI* v. *Camp*, *supra* note 17, the Supreme Court analyzed the scope of the Act in terms of specific "hazards" and "financial dangers" that Congress had in mind when banks engaged in activities prescribed by the Act. 401 U.S. at 630.

At the outset, the Board notes that since the stronger view is that commercial paper should not be considered a security for Glass-Steagall Act purposes, the sale of commercial paper by Bankers Trust is not prohibited by the specific terms of that Act. Accordingly, it does not appear necessary to examine the dangers that the Act was intended to eliminate.[38] Nevertheless,

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38 *See Aaron* v. *SEC*, 100 S. Ct. 1945, 1955 (1980).

the Board believes that the sale of third party commercial paper by a commercial bank could involve, at least in some circumstances, practices that are not consistent with principles of safe banking.[39] Thus, the Board, in cooperation with the other federal bank regulatory agencies, has initiated the process of developing guidelines governing the sale of third party commercial paper by a commercial bank designed to prevent potential unsafe or unsound practices that could arise in such an activity. When these guidelines are developed and submitted to the Board for consideration, the Board will address in that proceeding the general issues raised by the allegations of petitioners and the SEC relating to potential undue risks to banks or conflicts of interest arising from this activity.

Public Policy Considerations

A.G. Becker advances a number of public policy considerations that it claims militate against permitting a commercial bank to sell third party commercial paper. A.G. Becker first asserts that a full-service commercial bank selling commercial paper enjoys unfair competitive advantages over nonbank sellers because banks would be able to offer a package of services to an issuer of commercial paper that the nonbank seller could not offer. A.G. Becker also cites the potential for predatory pricing, access as settlement agent to the customer lists of competing sellers, and the cut-off of credit to nonbank sellers of commercial paper.[40] The Board's review of Bankers Trust's current operations in selling commercial paper has not uncovered any evidence at this time of such alleged unfair competitive practices.

It is next claimed that persons classified as "brokers" under the Securities Exchange Act of 1934 are subject to a number of

39 *See* 12 U.S.C. § 1818(b).

40 A.G. Becker claims that the asserted advantages constitute "unfair practices" by banks under section 18(f) of the Federal Trade Commission Act and the Board's Regulation AA. 12 C.F.R. § 227.

regulatory requirements designed to protect investors and that banks (which are exempt from the definition of broker in the Securities Exchange Act) are not subject to similar restrictions. However, since commercial paper is exempted from the definition of security in the Securities Exchange Act,[41] it would appear that a nonbank seller of commercial paper is not subject to the provisions of that Act if commercial paper is the only instrument sold. In any event, commercial banks are subject to certain investor protection requirements in connection with their securities transaction activities similar to those imposed on nonbank brokers. *E.g.*, C.F.R. § 208.8(k). Moreover, Bankers Trust sells commercial paper only to sophisticated institutional investors that would appear to be less in need of many of the safeguards designed to protect average investors.

Finally, A.G. Becker claims that if commercial banks become dominant in the commercial paper market, the resulting competition may reduce the efficiency of the securities industry and impair the capital-raising mechanism provided by that industry. Presently, however, Bankers Trust is by no means dominant in the commercial paper market and there is no available evidence of disruption of the capital markets as a result of Bankers Trust's activities. Accordingly, the Board believes that the policy considerations advanced by A.G. Becker do not at this time warrant prohibition of Bankers Trust's selling of third party commercial paper.

In summary, the Board has determined to deny the petitions of the SIA and A.G. Becker to the extent such petitions allege that Bankers Trust's commercial paper activities violate the Glass-Steagall Act or that such activities should be prohibited by general considerations of public policy. The Board is taking no action regarding petitioners' contentions of dangers to Bankers Trust and potential conflicts of interest and will consider these issues in the context of the Board's consideration of guidelines governing the sale of third party commercial paper by commercial banks.

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41 15 U.S.C. § 78c(a)(10).

Request for Oral Argument

Counsel for A.G. Becker has requested the opportunity to present oral argument to the Board when this matter is submitted to the Board for consideration. However, the Board as yet has initiated no agency proceedings in connection with Bankers Trust's commercial paper activities and A.G. Becker is not a party to any agency proceeding pending before the Board. The Board notes that counsel for A.G. Becker has met with the Board's staff on at least two occasions concerning the activities of Bankers Trust. Moreover, the Glass-Steagall Act issues resolved by the Board are essentially legal in nature and all the interested organizations have submitted extensive written arguments on these issues. In the Board's view, these written submissions adequately explain the issues involved and oral argument before the Board at this time would serve no useful purpose. Accordingly, the request by A.G. Becker for oral argument before the Board on this matter is denied.

Judgment of the Court of Appeals, December 23, 1986

UNITED STATES COURT OF APPEALS

FOR THE DISTRICT OF COLUMBIA CIRCUIT

September Term, 1986

Civil Action No. 80-2730

No. 86-5089

SECURITIES INDUSTRY ASSOCIATION

v.

THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, *et al.*

BANKERS TRUST COMPANY,

Appellant

Civil Action No. 80-2730

No. 86-5090

SECURITIES INDUSTRY ASSOCIATION

v.

THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, *et al.*

BANKERS TRUST COMPANY,

Appellant

Civil Action No. 80-2730

No. 86-5091

SECURITIES INDUSTRY ASSOCIATION

v.

THE BOARD OF GOVERNORS OF THE
FEDERAL RESERVE SYSTEM, *et al.*

BANKERS TRUST COMPANY,

Appellant

No. 86-5139

SECURITIES INDUSTRY ASSOCIATION

v.

THE BOARD OF GOVERNORS OF THE
FEDERAL RESERVE SYSTEM, *et al.*,

Appellants

BANKERS TRUST COMPANY

APPEALS FROM THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

BEFORE:

MIKVA, EDWARDS and BORK,

Circuit Judges.

JUDGMENT

These causes came on to be heard on the records on appeal from the United States District Court for the District of Columbia, and were argued by counsel. On consideration thereof, it is

ORDERED and ADJUDGED, by this Court, that the order of the District Court appealed from in these causes is hereby reversed and the Board's decision is reinstated, in accordance with the Opinion for the Court filed herein this date.

Per Curiam
For The Court

George A. Fisher
Clerk

Date: December 23, 1986

Opinion for the Court filed by Circuit Judge Bork.